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WASHINGTON STATE LEGISLATURE

Report on Special Investigation of the Office of the State Actuary

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Investigation and Report Perspective

Our team, composed of a professional auditor and a professional actuary, with significant support from the State Auditor's Office, was engaged by the Washington State Legislature in response to a set of assertions filed under Chapter 42.40 of the Revised Code of Washington, the Whistleblower Act. The response of the Legislature was to conduct an investigation in such a way as to satisfy the State Auditor's Office requirements under the Whistleblower Act and to provide advice as to issues of governmental structure, oversight and management practices of the Office of the State Actuary. As such, our work was guided by the State Auditor's Office and House and Senate Counsel.

This investigation was necessarily limited and focused on the issues related to the assertions. Had we investigated other issues, or had we conducted an overall study of the pension systems, other matters may have been included in this report.

The background of the investigation team influences the perspective of this report. With regard to our independence, neither team member has ever been engaged by the Washington State Legislature or the Office of the State Actuary. We have no other business or personal relationships that would be perceived as a conflict or otherwise impact our independence. Both of the team members have substantial experience with large corporate pension or other multi-employer benefit plans. The actuarial team member has a historical perspective of the pension systems from his service on the Washington State Public Pension Commission from approximately 1970 to 1977.

Investigation

The State Auditor's Office received assertions of improper governmental activity at the Office of the State Actuary. These assertions were submitted under the provisions of Chapter 42.40 of the Revised Code of Washington, the Whistleblower Act. We have investigated these assertions independently, objectively and thoroughly through interviews and by reviewing relevant documents.

Significant effort was involved in the review of actuarial working papers generated in the process of pricing pension benefit proposals and preparing fiscal notes. Other types of documentary information reviewed were contracting files, travel records, correspondence files, valuation reports, comprehensive annual financial reports, policy statements and statutes.

We conducted 30 individual interviews and met with one group of 11 labor representatives. We also held discussions with five individuals not involved in the assertions for certain background and clarification. In addition to interviews, we listened to taped hearings where applicable and relevant.

Several acronyms are used throughout the report. The following table explains these acronyms:

OSA	Office of the State Actuary
DRS	Department of Retirement Systems
JCPP	Joint Committee on Pension Policy
OFM	Office of Financial Management
ERFC	Economic & Revenue Forecast Council
AG	Attorney General's Office
RCW	Revised Code of Washington
WAC	Washington Administrative Code
PERS	Public Employees Retirement System
TRS	Teachers Retirement System
LEOFF	Law Enforcement Officers and Fire Fighters Retirement System
WSPRS	Washington State Patrol Retirement System
JRS	Judicial Retirement System
VFFRPF	Volunteer Fire Fighters' Relief and Pension Fund
GASB	Governmental Accounting Standards Board
CAFR	Comprehensive Annual Financial Report
COLA	Cost of Living Adjustment
PBO	Projected Benefit Obligation
RFP	Request for Proposal
UAAL	Unfunded Accrued Actuarial Liability
AFM	Aggregate Funding Method

The following pages present an executive summary and a report on the results of this engagement as described above.

March 9, 1998

Executive Summary

Assertions

Assertions are allegations of improper governmental action as contained in Chapter 42.40 RCW. Improper governmental action is defined by RCW 42.40.020 as any action undertaken by a state employee in the performance of the employee's official duties, which is:

- In violation of any state law or rule
- An abuse of authority
- Of substantial and specific danger to the public health or safety
- A gross waste of public funds

A whistleblower made 97 assertions of improper activity at the Office of the State Actuary (OSA), some of which were related to a single issue. We determined that 86 separate items (see Exhibit A of this report) were asserted. Of those, we recommended 38 should be investigated and they are discussed individually in this report. Those assertions range from the miscalculation of benefits for retired state employees to preferential treatment for bills sponsored by certain lawmakers. The other assertions did not fall into areas that may be examined under the Whistleblower Act.

Criteria

The Office of the State Actuary's creation and duties are found in Chapter 44.44 RCW. The OSA has broad authority to carry out its statutory responsibilities, which are:

- Providing actuarial services for the Department of Retirement Systems.
- Advising the Legislature and the governor on pension benefit issues.
- Consulting with the Legislature and the governor on the actuarial assumptions used by DRS.
- Providing staff support to the Joint Committee on Pension Policy.

Further responsibilities are found in RCW 41.45.030, .060, and .090.

The law does not require the Actuary's Office to comply with:

- State civil service law (Chapter 41.06 RCW).
- State personal service contract law (Chapter 39.29 RCW).
- The State Budgeting, Accounting and Reporting System Act (Chapter 43.88 RCW).
- The state's Open Public Meetings Act (Chapter 42.30 RCW).

State law does require the OSA to comply with the state Open Public Records Act (Chapter 42.17 RCW).

As such, we found it difficult to determine whether the alleged actions met the Whistleblower Act's first standard (violation of any state law or rule) for improper governmental activity.

Therefore, this investigation team was left with determining if an alleged action is an abuse of authority involving wrongful conduct that affects the performance of an official duty or is clearly inappropriate or not in the best interest of the body or constituency represented by the Officer[1].

In cases where a lack of statutory or regulatory criteria precludes a finding of inappropriate governmental activity as defined by the Whistleblower Act, we have described our objections to corroborated assertions by comparing them to usual and customary business practices used by private businesses that perform work similar to that of the OSA. We believe these discussions address the structure, oversight and management practices of the Office of the State Actuary in accordance with our engagement.

General Conclusions

Differences of opinion exist in actuarial work and the related communication of the results. While the whistleblower raised valid and relevant concerns about the office's activities, we found there were equally valid and relevant explanations for the Office's conduct.

Under these circumstances, and without specific standards governing OSA operations, we did not, in most cases, find that inappropriate governmental activity has occurred. We found one instance where we determined there is reasonable cause to believe improper government activity occurred. That involved the State Actuary removing information from a fiscal note.

We found evidence of an inappropriate work environment. The State Actuary's biases are clearly expressed, offensive statements are made and relevant information is withheld from the Legislature. Once again, because specific rules are lacking, we did not find improper governmental activity.

We found a few instances where the assertion is unsubstantiated or where the whistleblower had a limited perspective in which to judge wrongdoing.

The Structure

The OSA provides staff support for the Legislature's Joint Committee on Pension Policy (JCPP). The JCPP consists of 16 legislators who study pension issues, the financial condition of the state's pension systems and who develop pension policy. The JCPP has a five-member Executive Committee, a structure that is unusual in the Legislature. The performance evaluation and compensation of the State Actuary is determined by the Executive Committee.

[1] This definition is derived from two sources : 1) Article V, Section 3, of the State Constitution provides that "All officers not liable to impeachment shall be subject to removal for misconduct or malfeasance in office, in such manner as may be provided by law." 2) An officer's oath of office is violated by the failure to perform the duties of his or her office honestly, faithfully, and to the best of his or her ability. Bocek v. Bayley. 81 Wn.2d 831 (1973)

The current State Actuary has been in Office far longer than was originally intended when that Office was created. When originally created, the State Actuary was to have been appointed for a seven-year term that could not be renewed. The intent was to have an Actuary advising the Legislature whose continued employment would not influence the advice he or she gave. In addition, the State Actuary was originally required to have certain professional qualifications. The Legislature changed the statute creating the position so that the current State Actuary could be appointed and so that he could continue beyond the originally specified term.

The current State Actuary has become the "Ultimate Authority" on Washington state retirement systems. He is an author of much of the law that governs it. He is the interpreter of that law. He understands the operation of the plans –better than anyone else in the State. His knowledge and understanding heavily influences legislative and administrative decisions on pension plans.

Uniformly, the people we interviewed said the OSA takes its direction from the JCPP Executive Committee, a group whose actions are generally not open to the public or to the other members of the JCPP. Any relatively closed group in a legislative environment will generate suspicion and distrust in the group's processes and decisions. Those we interviewed disagreed whether this direction is beneficial. Some would state that the fiscal discipline and program consistency that this group provides was instrumental in overcoming the funding indiscretions of the past. Others would argue that independent actuarial services and open policy deliberations are paramount to fiscal discipline and consistency. We cannot solve these concerns. However, we can suggest that in an environment where the actions of the OSA are not viewed as independent, there is a much higher burden of full disclosure and in-depth analysis.

The management structure of the pension systems has changed over time. In 1963, the Legislature created the Public Pension Commission in an effort to oversee the entirety of state pension systems, which then were managed by separate boards. The separate pension boards were eliminated when the Washington State Investment Board (WSIB) was created in 1981. There currently exists a division of responsibilities between the Legislature (and the OSA), DRS and the WSIB. In such a distributed structure, a clear delineation of fiduciary responsibilities of the various parties to participants and beneficiaries is needed. We have briefly discussed these issues in the final section of this report.

Funding Method and Cost Disclosure

The whistleblower expressed concern that the State is not funding its pension plans in a reasonable manner and that the true cost of benefit improvements is not disclosed to the Legislature. While we find the State has improved the funding of its plans since 1989, there is room for more improvement.

For the most part, state law was followed when benefit costs were communicated to lawmakers. In cases where that did not occur, there is a legitimate difference in professional opinion. We believe the Legislature should understand more than is required by law. We have made recommendations for better cost information. We also believe the Legislature

too easily disregards expenditures of substantial amounts because they are allocated to future fiscal periods - though once committed cannot be reversed. We have made recommendations to put more emphasis on the total value of benefit changes.

Key Findings

The Legislature seldom understands the total cost of benefit improvements. It improperly concentrates on the relatively small portion of cost attributed to the current fiscal period. It is seldom, if ever, advised of the increase in value of benefits related to past fiscal periods.

- Because the Unfunded Accrued Actuarial Liabilities for the pre-1977 plans have grown since 1986, the funding method is subject to criticism. The funding method inherently pushes funding to future periods, thus accounting for growth in the Unfunded Accrued Actuarial Liability from 1986 to 1995.

- Costs of paying benefits should be recognized in the fiscal period in which the service leading to those benefits is performed.

The Information Provided

The current flow of information provides only one perspective. We recommend the JCPP review this, keeping in mind that having more than one perspective may lead to more responsible decision-making.

In situations where the cost development is imprecise or the amounts are minor, the OSA should communicate such imprecise or small amounts in a meaningful manner. Greater effort should be made to help legislators understand the true long-term cost of benefit improvements. In addition to the current requirements, fiscal notes should disclose any increase in the value of benefits attributable to prior service and the total present value of new benefits.

Key Findings

- The structure of the Office of State Actuary and its relationship with the JCPP creates perceived conflicts. All recommendations and plan designs come from the Executive Committee in a way that is not open to discussion. In addition, the State Actuary limits the information about actuarial assumptions and methods he provides to the public.

- There are few controls on the sufficiency and quality of information flowing from the Office of State Actuary. The whistleblower and others interviewed expressed concerns regarding a lack of full disclosure by the State Actuary, including instructions to change information depending on its impact.

    - The State Actuary removed information in a 1997 fiscal note identifying an increase in the Unfunded Liability.

    - The State Actuary presented the benefits of the Uniform COLA on a 10-year basis, rather than on a present value basis, which may have been done to make the COLA appear more favorable.

Clarification of Statute

We believe that issues relating to necessary clarification of statute have varying degrees of risk to the state and should be addressed in a wise and judicious manner. Both DRS and OSA should develop and report recommendations to solve significant implementation issues. The Legislature should allow such discussions to occur.

Key Findings

When an issue of legal interpretation involving the TRS I savings withdrawal arose, the State Actuary took no steps to resolve the issue.

- In a case involving an inconsistency between the administration of a COLA and existing statute, the State Actuary took no steps to reconcile the inconsistency.

Involvement in External Processes

No improper governmental activity was established for any of the assertions regarding involvement in external processes. As such, we have no recommendations for improvement in this area.

Work Environment

The OSA has experienced significant staff turnover in the last few years. Those that have left hold a strong belief that the office work environment is inappropriate. Current employees are less likely to express such thoughts. The Office is not bound by civil service requirements or other conventional means to protect the interests of employees. We believe that expertise such as that provided by the Department of Personnel would be beneficial but since the OSA is a legislative organization, it is unclear how that might be accomplished.

Key Findings

The State Actuary has made unprofessional remarks. Employees interpret his remarks to indicate he favors certain legislators who he holds in high regard and disfavors others who he does not hold in high regard.

- The State Actuary misrepresented that a consultant contract was for an audit when it was actually just for a review of the approach, format, style and techniques of fiscal notes.

- An actuarial firm that wrote the RFP for a contract was eventually awarded the contract, resulting in an appearance of a conflict of interest.

Conclusions

A summary of our conclusions and recommendations follows this report.

Acknowledgments

We wish to recognize the cooperation of the Office of the State Actuary in the conduct of this investigation. Assistance in providing work space, staff availability and documentary information was instrumental in the timely completion of this investigation.

We would also like to thank the Washington State Auditor's Office for providing expertise, staff support, access to Attorney General services and work and meeting space. This investigation could not have been accomplished without their significant involvement.

Finally, we wish to thank all of the legislators, legislative staff, agency staff and others who participated in this investigation.

Pension Funding & Cost Disclosure

Summary and Recommendations

We have determined there is no reasonable cause to believe there has been improper governmental activity regarding funding-related assertions.

However, we find it unlikely state lawmakers always fully understand the cost of many benefit improvements presented to them each session. We believe the Legislature:

- Improperly concentrates on the relatively small portion of cost that is attributed by the current methods to a current fiscal period.
- Seldom, if ever, understands the **total cost** of a new benefit over time.
- Is seldom, if ever, advised of an increase in the **value of benefits in respect of service already performed.**

The current pension funding methods established by the Legislature in 1989 were an improvement over prior methods. The 1989 changes established a firm commitment by the Legislature to fund the systems. Before 1989, the Legislature did not consistently make the actuarially required contributions.

The method used to amortize (spread the cost to future years) the unfunded obligations of the pre-1977 plans is still subject to criticism. **This method inherently pushes funding to future periods. This accounts for the growth in the Unfunded Accrued Actuarial Liability between 1986 and 1995.** This issue is amplified when benefit enhancements for the employees covered by the old plans are adopted by the Legislature. The costs of these enhancements are allocated more to the long term than to the near term.

Since the current funding method is an improvement from past practices, we would be hard pressed to make any recommendations which involve changing funding methods. The State should not deviate from its recent pattern of contributing the amounts required by the current method of funding.

We recommend that:

- The JCPP see a presentation comparing the current funding method for old liabilities to a method that allocates contributions evenly, in dollar amounts, over the funding period. If for no other reason, this will show how much old cost is being deferred.
- The JCPP see a presentation comparing accumulated assets with the value of accumulated benefit obligations for each of the plans. Keeping in mind that states have generally been very lax in funding these benefits, they should see how Washington State

compares to other states, how these amounts have changed over the years and how recent legislation has affected these amounts.

- The Judicial Retirement System should be funded to at least the same extent as the other plans.

- Greater effort should be made to help legislators understand the true, long-term cost of benefit improvements. In addition to current requirements, fiscal notes should disclose any increase in the value of benefits attributable to prior service and the total present value of new benefits.

Funding Fundamentals

Nearly all of the benefits provided by the State's retirement system provide a benefit based on an employee's years of service and earnings near to retirement. A significant factor in the estimate of costs is a projection of employee earnings many years in the future.

Actuarial valuations and fiscal notes attached to proposed legislation are intended to show how the costs of the State's retirement systems are allocated to fiscal periods. How much should have already been paid? How much should be paid in the next fiscal period? How much will be paid in later fiscal periods? How long will the State (or employer) have to pay?

Costs for employee benefits should be recognized in the fiscal period in which the employee's service that leads to those benefits is performed. All of the cost of a retirement benefit should have been recognized by the time the employee retires.

On the surface, the best way to allocate costs to fiscal periods would be to determine the cost as a level percentage of each employee's pay from the day of his or her hire until the day he or she retires. All of the State's funded plans start approximately from this basis:

1. PERS I, TRS I and LEOFF I (hereafter called old plans) use the level percentage determined for the average employee covered under PERS II, TRS II and LEOFF II and their newer versions (hereafter called the new plans). This does not cover the full cost of the benefits.

Many of the participants in the old plans are nearing retirement. Assets have been accumulated in these plans over the years but not enough to cover that portion of the benefits that will not be paid by the percentage described in the previous paragraph.

What's left over is called the **UNFUNDED ACCRUED ACTUARIAL LIABILITY (UAAL)**. In 1989, the state undertook to pay this over 35 years as a level percentage of all of the payroll of each of the systems – it is allocated to fiscal periods as a constant percentage of the **total payroll of all public employees** until 2024 and likewise for the teachers, the law enforcement officers and firefighters.

This allocates an **ever-increasing** dollar amount of the cost for old benefits to future years. Under this method, the unfunded liability was larger in 1995 than it was in 1986 even though investment results had been good and

inflation had been modest. (Fortunately, investment results have been very positive since 1995 and it is likely that a current valuation will show improvement.)

However, billions of dollars in unfunded liabilities remain to be funded. It is quite a contradiction to hear the Legislature dealing with gain sharing if you know that these obligations, accrued in the past, remain to be funded by an ever-increasing dollar amount over another 26 years. It would not be surprising for a glitch in revenues to compromise this funding program sometime during that period. This method was adopted because the previous methods were compromised by poor revenues during the 1980s.

2. The New Plans use the Aggregate Funding Method. They start with a normal cost determined in the same way. However, everything that has happened since inception has resulted in an adjustment to the normal cost. For example, a reduction in the normal retirement age in LEOFF II has been allocated to the normal cost and spread over future pay even though a portion of the new benefits value is associated with past service.

In this report, the State Actuary will rationalize that no unfunded liability needs to be disclosed in some cases because the funding method (**the aggregate funding method**) does not identify such an amount. **There is, however, often an increase in the value of the benefits already accrued by the employees.**

The statute requires that fiscal notes on proposed pension legislation be prepared by the Office of the State Actuary. The State Actuary must disclose the **Present Value of Unfunded Accrued Benefits.** The new plans have more assets than accrued benefits. There has been legislation that increased the value of Accrued Benefits - but not enough to create an unfunded situation. The State Actuary has sometimes determined it is not necessary to disclose there is an increase in cost attributable to the past because of this provision. We feel that legislators should realize in such situations that they are adding to the accumulated obligations of the state (or other involved employers) even though the affected plan may not have unfunded benefits.

Funding in Other States

It should be noted that the aggregate funding method is uncommon for public pension plans. In its Statement No. 27 entitled *Accounting for Pensions by State and Local Governmental Employers,* The Governmental Accounting Standards Board cited (paragraph 191) a study on this issue. The GASB stated that:

> "Relatively few plans use the aggregate **method**; for example 6 percent of 451 plans included in a survey conducted in 1993 by the Public Pension Coordinating Council reported using that method, and most are small plans."

This does not mean this state is using this method inappropriately for the new plans. It may well mean that other states, many with larger plans, have chosen to spread some of their obligations over periods longer than the remaining work life of the covered participants, just as Washington has done with its Old Plan obligations.

The condition of state pension funds often is measured by comparing assets on hand with benefits already earned, or the funded ratio. This is the measure used in a 1994 survey by A. Foster Higgins of funded ratios for Governmental Accounting Standards Board disclosure purposes. It was found that 16 states (32%) were over 100% funded, close to 60% were over 90% funded and the average for all states was 95% funded. Washington was slightly under 80% in 1992 and 90% at 6/30/95. **Therefore, Washington probably is still below average but funding levels are improving.**

Assertions

The following are the assertions we believe raise specific concerns regarding the funding method and cost disclosure. Other assertions made by the whistleblower that relate to funding are not as specific. In particular, four assertions covered in the "BIAS IN INFORMATION" section relate to the disclosure of cost and unfunded liabilities. We have taken these into account in our conclusions and recommendations for this section.

We considered Chapter 41.45 RCW in this portion of our investigation. There are no other statutes regarding pension funding methods. Customary governmental and private sector actuarial practices can be found in the accounting standards boards, GASB and FASB, regarding the relationship between actuarial liabilities and assets. The Actuarial Standards Board in its Actuarial Standards Practice No. 4, *Measuring Pension Obligations,* has provided criteria by which we have developed our recommendations. Our recommendations have also been influenced by our experience with private single and multi-employer pension plans.

ASSERTION

The table below indicates the Unfunded Accrued Actuarial Liability (UAAL) in 1986 and again ten years later. Please keep in mind that the increase in UAAL (debt) of over a billion dollars has taken place during the greatest bull market any of us will live through and that assumptions are much more permissive now.

UAAL in Millions	**1986**	**Current**
PERS I	$2,238	$3,388
TRS I	$2,253	$2,563
LEOFF I	$ 992	$ 677
TOTAL	**$5,483**	**$6,628**

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The historical record confirms the whistleblower's assertion. **The Unfunded Accrued Actuarial Liability for these closed plans has grown since 1986.** On the surface, this should be of concern to all citizens of the state. If the Unfunded Liabilities have grown, payment of obligations must have been deferred.

There is an implication in the whistleblower's assertions that the State Actuary is responsible for the adoption of an unreasonable funding method.

The current State Actuary did guide the Legislature in its adoption of these methods. Actuaries can find much to debate in deciding which funding methods should be used by governments.

We should also note that while the amounts disclosed in the assertion are consistent with the formal 1995 valuations, these amounts do not reflect very positive investment performance during the last few years. The unfunded liabilities will have declined, and the funded ratios will show considerable improvement in more recent valuations.

ANALYSIS

In our opinion, the methods adopted in 1989 are reasonable for these circumstances. The obligations of the plans are being funded in an orderly manner with the remittance of contributions that are a relatively constant percentage of the payroll. While the growth in unfunded accrued actuarial liabilities means that the payment of obligations is being deferred, sources of revenue with which to pay those obligations have been identified and are not expected to become onerous.

As long as these contributions are made in accordance with the standard established in 1989, the Unfunded Accrued Actuarial Liability will be eliminated by 2024. This is a considerable improvement over the situation prior to 1989.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

One of the consequences of the funding chapter will appear in the 1997 state's Comprehensive Annual Financial Report (CAFR). New accounting standards prohibit the use of the state's current funding method in annual statements. When we display the amounts actually contributed, and the amounts required, we will not be allowed to use the results of the most current valuation. Instead we will use any one of four commonly accepted methods. The underfunding will be disclosed as an addition to the long-term debt account group. Earlier this year, before the 1996 valuations were completed, the State's share of the underfunding of PERS was about $80 million dollars. There is an open question as to whether the state's CAFR should disclose underfunding for TRS or LEOFF. Some believe the members of these systems are not state employees and, therefore, there should be no disclosure. Others believe the state is funding these employees and responsible statutorily for their pensions, so the underfunding of their systems should be disclosed. If TRS and LEOFF underfunding were disclosed, the amounts would be $147 million and $57 million respectively (using 1995 figures).

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The central issue in this assertion is that the new accounting standard highlights the aggressiveness of the current funding method. A secondary

issue is the appropriateness of decisions made to exclude the disclosure of unfunded liabilities related to TRS and LEOFF employees.

We obtained the 1997 CAFR and noted that the increase to the Net Pension Obligation for 1997 was $59 million based on 1996 valuations. This additional amount was calculated using one of the "four commonly accepted methods" mentioned in the assertion.

We discussed this issue with a representative of the Office of Financial Management (OFM) who said the difference was that the GASB would not allow the amortization of the unfunded liability over both plan I and plan II members. As such, a difference between required contributions (as GASB defines) and amounts actually contributed would amount to this approximate amount. This individual concurred that if the same approach was used for TRS and LEOFF, the amounts might be of the magnitude of the assertion, but he believes the state is properly interpreting the new GASB standard by not treating TRS and LEOFF members as employees of the state. The amount of the state funding to these employer groups is not viewed by OFM as an item to be considered in the calculation of the net pension obligation.

We researched the portion of the GASB statement that addresses special funding situations. This statement discusses the situation where one legal entity is responsible for making the annual employer contribution to a plan that covers employees of other legal entities. The statement requires the entity that is *legally responsible* to comply with all of the requirements of GASB Statement No. 27. The state appears to have made a proper assessment that schools districts are legally responsible for their employees. The state funding of basic education is too indirect in relation to pension contribution requirements to suggest that school district personnel are state employees. We are not as confident, however, that the LEOFF state contributions could fall into this same excluded category.

We discussed this issue with a representative of the State Auditor's Office, who researched their working papers and noted the information was provided by the OSA. They agree with OFM on the position taken and thought the OSA also agreed.

ANALYSIS

The responsibility for financial statement disclosures is shared by OFM and the OSA. Together, they made an interpretation on how to implement this new GASB statement. While portions of their conclusions are subject to challenge, they are also reasonable.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

The selling of the plan - - It was said to be cost neutral. However this was only close to true in the most narrow of cases. First, the mix of PERS and TRS costs varied from the old COLA. Thus, the General Fund cost was about the same, but local government costs would rise. Second, and more important,

costs started out the same, but declined rapidly for the old COLA, and increased sharply under the new. In sum, a bill described as cost-neutral created an increase in unfunded liabilities of hundreds of millions of dollars.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The assertion implies the JCPP agreed to the concept of a uniform COLA for TRS I and PERS I when the committee was told the changes were cost-neutral, despite the fact that there was substantial real cost. This is confirmed from material distributed to the JCPP at its November 30, 1994 meeting. This material definitely describes the change as being cost-neutral to the general fund. It does not identify any increase in unfunded liability. However, the same material shows real cost to non-general funds and local government. It is obvious there is a positive cost.

We noted an entry on the 1995 bill tracking form maintained by OSA as SHB 1083 and SSB 5119, Uniform COLA. We obtained the working files for this legislation and found the fiscal note, which states that the contribution rates and unfunded liability increase.

We cannot verify whether the members of the JCPP really understood, at that time, there were added costs to employers for additional benefits.

The JCPP resolved to recommend the Uniform COLA to the Legislature at its (JCPP) meeting of December 20, 1994. Material distributed at this meeting included a fiscal note showing definite and substantial costs, including an increase in the unfunded liability. This version is not cost neutral to the general fund and the note does not say that it is. When the bill reached the Legislature, the fiscal note showed even greater costs and did not say that it was revenue neutral. This legislation makes permanent a temporary benefit that was granted in 1993 - that is where much of the cost arises. So, some may consider that the cost was inevitable, a continuation of previous practice, or the fault of a previous Legislature.

ANALYSIS

We believe the change in information provided is explained by the perspective, as first presented, that moving from the current (temporary) practice to a permanent practice does not involve increased costs. The practice of preparing fiscal notes, however, requires that temporary benefits are not considered in determining costs. When these temporary benefits are not considered in calculating the fiscal impact, the costs are significant.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

The JRS was closed July 1, 1988. In coming up with a method of funding the Unfunded Accrued Actuarial Liability, my recommendations were all within actuarial principles and standards. Jerry directed me to come up with a method that would lower the required amount. We ended up with a method

that amortized costs over the salaries of judges who are not members of JRS.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The core issue in this assertion is that the State Actuary selected a method which was not within actuarial principles and standards.

We obtained the 1988 valuation for JRS, noting several places in which the amortization method was described as being “over the salary of all Appellate, Superior and Supreme Court judges.”

The State Actuary stated this system is a pay-as-you-go system and now it's closed. The method when it was open was to amortize over 40 years. When it was closed OSA decided to keep doing what they had been doing before. Because this system is not advance funded on an actuarial basis, the amortization method selected for valuation purposes has no impact on annual funding requirements.

JRS was not included in the 1989 law that adopted a uniform pension funding method and the requirement to appropriate funds routinely. We know of no reason why this plan should not be funded in the same manner as the other plans except that it is relatively small.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

The 1970s and 1980s were a period of chronic underfunding of the state's pension plans. A common approach was to have the Office produce the rates required by statute and then someone would ask for the amount required by the "earned benefit" approach (the Unit Credit Method). The earned benefit developed a very bad name and was something legislators were trying to get away from when they adopted a new method. Jerry's new Funding Method would produce a 1989-91 LEOFF contribution of less than the "earned benefit" cost (albeit $1,000,000). Jerry then changed the figures for LEOFF to make the new funding method equal "Earned Benefits" (Accrued Benefit, Unit Credit).

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower alleges the State Actuary represented the costs under the new funding method as being the same as the earned benefit approach when it was not.

We obtained the OSA’s 1989 session folders for House Bill 1321, Pension Funding, which would establish a new actuarial funding of the state’s pension funds. These files contained the fiscal note prepared by OSA, that

compares the "current" recommendations to the HB 1321 recommendations. We located a spreadsheet that appears to compare the proposed new funding method to the earned benefit method (another more conservative method). This spreadsheet shows that the LEOFF cost for 89-91 was $124.0 million and $124.9 million for new funding vs. earned benefit, respectively. The fiscal note, however, contains the $124 million amount. As such, even though the whistleblower was accurate in the discussion of the differences between the two methods, the fiscal note clearly was not changed to equal the earned benefit amount for LEOFF.

Some of this assertion alludes to the reasonableness or unreasonableness of the actuarial funding method adopted in 1989. Please see the first assertion in this section for a discussion of this aspect.

CONCLUSION

The whistleblower's concerns about the reasonableness of the actuarial funding methods are justified, but we have previously discussed that aspect of this assertion. The specific assertion about the contents of the fiscal note is unfounded. We have, therefore, determined there is no reasonable cause to believe improper governmental activity has occurred.

Bias in Information

Summary and Recommendations

The Office of the State Actuary, as a creature of the Legislature, provides staffing for the Joint Committee on Pension Policy. The OSA also provides actuarial services to the executive and legislative branches of government.

This structure and set of responsibilities create conflict among OSA staff, as well as in the minds of interested parties (e.g., labor organizations and plan beneficiaries). Information control in such a complicated field could foster abuses in the area of full disclosure and advising on one's own recommendations.

RCW 44.44.040 (4) requires the OSA to prepare fiscal notes on pension related bills and the minimum information required. We found, however, that no statutes, policies or procedures govern the sufficiency and quality of information flow. During this investigation we found differences of opinion on how much information should be given to legislators, employees, unions, retirees, other state agencies. We also considered the requirements of the Public Records Act in this investigation.

Currently, only one perspective is given on proposed legislation. A gap exists between the expectation that information be independently developed and the actual OSA processes. Certain individuals believe the information and analysis should be detached from the processes used to produce legislation.

We found one instance (see the first assertion reported in this section) where the "cost" of a bill was not fully explained in a fiscal note. We believe this instance represents improper governmental activity. We found several instances where the underlying facts of the assertion were substantiated, but because of a lack of state law regarding such activity or because the acts were found to be within reasonable application of the State Actuary's authority, no improper governmental activity was found. We found a few instances where the substance of the assertion was unfounded.

We recommend that OFM and the JCPP review how fiscal impacts of pension bills are developed and communicated. In situations where the cost development is imprecise or the amounts are minor, the OSA should communicate such imprecise or small amounts in a meaningful manner. Greater effort should be expended to help legislators understand the true long-term cost of benefit improvements. In addition to the current requirements, fiscal notes should disclose:

- Any increase in the value of benefits attributable to prior service.
- The total present value of new benefits.

Assertions

The following are assertions regarding an alleged bias in the information provided to the Legislature. The final assertion of the previous section could also be considered in this category, but will not be repeated.

During our investigation of assertions related to bias in information, we discovered evidence that does not relate to any specific assertion, but is relevant to this section and the section on inappropriate work environment issues.

The following is a composite of several different interviews that indicate a prevailing perception among several individuals.

> Concerns were expressed regarding a lack of full disclosure by the State Actuary during testimony on legislation. Many times the State Actuary did not discuss important or relevant facts. Staff was instructed not to discuss the costs of a specific proposal and to "just tell (legislators) what they should know." Staff said legislators were not told all they should have been told. Staff occasionally found errors in fiscal notes. If the correction of the error made the price of a proposal more favorable, a fiscal note was immediately revised. If the correction of the error made the cost of the proposal less favorable, then the fiscal note was not corrected. The State Actuary is selective about information he provides. He does his best to guess what key legislators want to know. On one occasion staff was instructed to focus only on the negative facts and to ignore positive facts. They were instructed "don't tell anybody about that". The Actuary would represent a proposal as cost-neutral, yet he did not use standard assumptions and he didn't want anyone to know what his definition of "cost-neutral" was. Legislators don't have any interest in knowing the whole story. Most pension-related recommendations come from the JCPP Executive Committee after they are developed by the State Actuary. These recommendations are not developed in a way that would open up discussion on the issue. Plan design may be deliberated inside the Executive Committee but not outside of the Executive Committee. The State Actuary is directed by this group.

We found no documentary evidence of instructions to not correct fiscal notes or otherwise withhold information from legislators. Of course, we would not expect to find such documentary evidence in the files. However, due to the consistent and cross corroborating theme throughout many of our interviews, we felt it necessary to disclose the results of this portion of our investigation. We are not creating a new assertion to be investigated. We are merely reporting information we believe does not fit neatly into one of the assertions under investigation.

ASSERTION

Please see draft of fiscal note for HB2017, dated 2/20/97. Please note the typed text was as I wrote it. The handwritten blue marks are mine, and the black is Jerry's. Please see the second page. Note there was information on the Unfunded Liability and Jerry removed it. Please note the difference between the original and final language.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower maintains these changes were made because the State Actuary did not want to disclose the true cost of the proposed law.

We reviewed the documents and have confirmed the changes did occur. The State Actuary acknowledges he made the changes to the draft, but maintains the changes were made for good reason rather than because of a bias on his part.

The State Actuary maintains that disclosure of such a small amount implies far more accuracy in the estimate than is possible. In fact, he questions whether their work could have determined such an amount with any confidence.

There are no unfunded liabilities in either TRS II or TRS III. The method used to determine the contribution rate spreads all benefit obligations that are not yet funded over prospective payroll. So this method inherently never results in an unfunded liability. Also, assets already accumulated exceed the liability for accrued benefits.

RCW 44.44.040 requires that fiscal notes disclose the amount of any unfunded accrued benefits. In this situation, there are no unfunded accrued benefits because of the funding method utilized. The whistleblower's workpapers indicate there will be a reduction in assets that would have paid for other benefits. As such, there is an increase in accrued benefits which have not previously been funded.

ANALYSIS

Regardless of the amount or preciseness of the impact, the evidence indicates the bill created an unfunded liability. The law requires this impact be disclosed in the fiscal notes. The disclosure was removed by the State Actuary. We don't believe the unusual nature of this particular unfunded liability impact is a compelling argument for its removal from the fiscal note.

CONCLUSION

The State Actuary must use judgment as to how these complicated concepts will be presented to the Legislature. However, the requirements for fiscal note preparation clearly require the inclusion of unfunded liability impacts. As such, we have determined there is reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Please see note of February 9, 1995. A poorly worded bill needed attention. We could price the bill as worded, or as intended; the two were different. His response was contingent upon who wrote the bill. It was someone he did not like so he said to go out with the higher cost and that would kill the bill.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower alleges favoritism .

By searching the bill tracking report for 1995, we found the bill in question was Substitute Senate Bill 5118. We obtained the workpaper files for this bill and noted that two fiscal notes were prepared. The fiscal note prepared February 21, 1995 discussed the number of people affected and provided a cost figure. The later fiscal note stated it only applied to deaths between June 1994 and September 1994 and stated the cost was inconsequential. Apparently the fiscal note did go out with a higher cost, but was later changed.

We interviewed the bill sponsor to obtain an explanation regarding the two fiscal notes and their differences. We provided the bill sponsor copies of the two fiscal notes which helped to refresh the memory. The sponsor said the bill needed changes because it was too broad and that the second fiscal note more accurately reflected the intent of the legislation. The sponsor's opinion was that the first fiscal note probably accurately reflected the earlier version, which was too broadly worded.

Most individuals interviewed stated the OSA needs to make judgments about bills. The OSA encounters many poorly worded or otherwise "bad" bills. They do not always have the time to obtain an understanding of the bill's intent necessary to help rewrite or clean up bill language. When these situations occur they simply price the bill as worded. As such, the situation described in the assertion would not be uncommon. All of the legislators and some staff are comfortable with these constraints.

Given the status of the bill sponsor as a long time JCPP member, we believe it unlikely that the OSA would have any motivation to intentionally provide information to kill this bill.

The portion of this assertion which implies a like or dislike of specific legislators is best covered in the inappropriate work environment section of this report.

CONCLUSION

The act of pricing the initial bill as worded as opposed to as intended apparently caused the necessary discussions to take place in order for the bill wording to be clarified in the legislative process. In the final bill, the wording was changed to more accurately reflect intent and was priced accordingly. This was a desirable outcome. We have, therefore, determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Please see note of February 15, 1995. A fiscal note was requested but one was never sent because it was for a legislator Jerry did not like.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower alleges favoritism.

We reviewed the statute pertaining to the OSA. Specifically, RCW 44.44.040 requires a fiscal note to be prepared for each pension bill introduced and for all amendments offered in committee or on the floor. The only exception is

that a majority of the members present may suspend such requirement for amendments only.

We obtained the bill tracking report maintained by OSA for 1995, 1996 and 1997. We noted no instances of a fiscal note request that did not have a logged entry for when the fiscal note was sent for 1997 and 1996. We did note, however, that three bills for the 1995 session did not reflect logged dates for the fiscal note being sent. We resolved these three items through discussions with bill sponsors.

We have interviewed eight JCPP members and asked if they had any direct knowledge of whether a fiscal note request was not honored. Two of those interviewed indicated a direct knowledge of an information (not a fiscal note) request not being met. Three of the eight stated it was entirely possible that legislators would have strange requests that were not met or times when the legislator did not receive exactly what they wanted. Sometimes legislators are not very clear about what they want. Since we were unable to determine the specific bill or fiscal note referred to in the assertion, we were unable to be more specific in our questioning. Based upon our interviews, the assertion itself is unusual since fiscal notes are required for bills with fiscal impacts and the process is monitored by OFM.

The people interviewed consistently stated the State Actuary is fully aware of the priorities of the fiscal committees and JCPP committees. None of the those interviewed expressed direct knowledge of a fiscal note not being prepared, but several explained the commonly encountered circumstance where this would be the case. If a bill was not likely to pass, (for example, if a fiscal committee stated they are unlikely to support a bill since the JCPP had not reviewed it), the priority is, established as low and, due to time pressures, the fiscal note is not prepared by cutoff date. The State Actuary is provided this specific direction by the fiscal committees and JCPP executive committee.

The portion of this assertion which implies a like or dislike of specific legislators is best covered in a separate section of this report.

CONCLUSION

Based upon our interviews, review of bill tracking reports and review of statutes, the likelihood that a fiscal note would not have been prepared for a pension-related bill is remote. Therefore, we have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Please see note of April 11, 1997. The determining factor as to whether or not a fiscal note has an example is whether or not the State Actuary likes the bill.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower alleges that the quality of work for legislation supported by the State Actuary is better than for other legislation.

We obtained all of the pension-related bills directly from OFM for the 1996 and 1997 sessions. Of the 19 pension-related bills in 1996 only two

contained examples. Of the 32 pension-related bills in 1997 only four contained examples. We noted that examples exist when the impact is on a low number of members and beneficiaries or when portability impacts additional employer contributions. We also noted that these six bills involved seven sponsors (including companion bills). One sponsor was involved with three separate bills. No other sponsor was involved more than once. Two of the six bills were noted as JCPP bills.

ANALYSIS

Determining whether the State Actuary likes a bill can be accomplished by reviewing JCPP involvement in the bill. This is based upon the work conducted for other assertions. Six examples in fiscal notes out of 51 bills had a commonality of nature of subject matter but had no other characteristics in common. We doubt the State Actuary only "liked" six bills during this time period.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Please see note of May 23, 1997. The "New Hire", Steve Nelsen, was surprised to hear that Senator Fraser's request for information (regarding contributions for the 97-99 biennium) from the last JCPP meeting would not be met.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower alleges favoritism.

We interviewed the individuals named in the assertion and specifically asked them about this alleged incident. Senator Fraser responded she did not remember the specific incident and that the information eventually was obtained.

Steve Nelson has no recollection of this incident. He didn't remember either the request or any discussion of withholding such information. He didn't remember being surprised.

We have learned that OSA staff is present at the meeting of the JCPP and the executive committee of the JCPP and that they listen to the deliberations. The next morning all staff have a debriefing meeting where they discuss their impressions. Sometimes the issue of an information request is discussed and it is decided that a response is not needed because the information was not needed, had already been provided or was irrelevant.

CONCLUSION

The underlying facts of the assertion have not been substantiated. As such, we have determined there is no reasonable cause to believe there has been improper governmental activity.

ASSERTION

Please see note of 3-12-91. We went out with a fiscal note on a bill for the JRS to refund contributions for withdrawn (or non-re-elected) members. The Representative wanted the smallest possible cost to help get the bill through. After coming up with a cost of $92,000, I asked Jerry four times if we could indicate this was an upper bound and that if beneficiaries were no longer alive the cost would be lower. He said no. Jerry has always thought the Judges and JRS are very rich systems so the members should not get any benefit increases.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower alleges that a legislator's request was not seriously addressed and that a fiscal note was inaccurate.

This assertion involves HB 1721 from the 1991 session, which would have refunded contribution to certain judges. Twelve JRS members would be affected but OSA had no idea how many were still alive. Apparently some had left service some time ago.

We obtained the revised fiscal note (for $93,558 vs. $92,000) dated March 21, 1991 noting the amount had slightly increased, but the description remained regarding the discussion of benefiting only twelve members. We also obtained a copy of a hand written note from the actuarial files, prepared by the whistleblower, addressed to the State Actuary stating that the representative's office believes that only five would be affected at a cost of $50,000 and that they were expecting to hear from OSA soon.

The accumulated contributions for all 12 judges amounted to $93,000. No one knew when the fiscal note was prepared whether some had died. The "potential cost" had to be presented as $93,000. It would seem reasonable, however, to state in the fiscal note that a cost could be lower.

While not recalling this specific issue, the State Actuary asserted that if he was questioned four times, he would have remembered this issue. He also asserted that he would not object to putting the words "upper bound" in a $92,000 bill. It would be possible, however, if a fiscal note had already gone out, he might have said to not make the revision.

We obtained the actual impact of this bill from DRS noting that 15 judges were paid refunds totaling $127,486.

ANALYSIS

While there is sufficient evidence to suggest that the concerns of the bill sponsor were not addressed, the actual cost of the bill exceeded the fiscal note amount.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Please see note of December 9, 1993. We were asked to practice "Actuarial Obfuscation". Jerry thought the visibility of a long-term assumption of 5.25% salary increases would raise objections with employees whose raises were not as high as 5.25%. Thus, we should hide the salary increase assumption by mixing it in with an interest rate factor, annuity factors, etc.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The core issue is the lack of full disclosure as to assumptions used in calculations affecting employee benefits.

We believe this issue involves an employee who had taken a refund of his/her pension contributions and forfeited the corresponding benefit. He/she wanted to repay some time later and recover the benefit. The Actuary calculated the amount to be repaid. The amount must be the actuarial equivalent, matching the methods spelled out in Washington Administrative Code. All sorts of assumptions (interest, mortality, salary increase, CPI, etc.) could enter into the calculation. Presenting the details opens up many avenues of dispute. Actuarial “obfuscation” reduces the potential for ongoing dispute over the details of the calculation.

The State Actuary is not aware of the specific communication referred to in the assertion. He said he would not be surprised to have made this decision, because he believes the OSA doesn’t need to tell the member every actuarial assumption or method used in the restoration calculation.

Even though the nature of the communication is very different, the following discussion is provided in the interest of fairly considering this assertion.

We believe that to be somewhat consistent, the same criticism could be made of the "interest factor" the OSA developed for the extra contribution to be made upon the transfer of port and university law enforcement officers from PERS to LEOFF (see item in the statutory interpretation section of this report.) The "interest factor" is really a catchall for several different details that affect the value that must be received by the plan in order to not create new costs for the state. We believe the actuarial staff came up with the simplified interest factor on its own, rather than having to explain and defend all of the underlying assumptions in the calculations. No such similar criticism was made against a very similar simplification.

ANALYSIS

Limiting the amount of information available to a pension system member could be viewed as a wise use of administrative resources. From a business perspective, this decision makes sense. This act, however, could be viewed as an affront to the concept of open government. We know of no statute or state policy which defines the sufficiency of information that should be provided to the public or a system member.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Please see note of June 1, 1995. The contribution rate increase for improving the PERS I out-of-service vested member is roughly .01% of pay. I had been asked to keep reviewing my assumptions until the cost came out to less than .0049% - and thus are rounded to 0.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower alleges the cost of a proposal was withheld through the use of assumptions and rounding.

We obtained the working file for what appears to be the work on this issue. Based upon our review of these working files we found a few different pricing runs with different combinations as was asserted. We also found a pricing run for .0049% rounded to 0% with a cost of $7,916,004. It does appear the portion of the assertion regarding the various pricing runs has been corroborated.

This series of pricing runs involved HB 2194. The State Actuary stated he disagreed with the assumptions used on the first pricing run. The largest group of people with the largest impact on the liability are the individuals who would leave PERS I and transfer to TRS II. All of the portability of this type happens in the first two or three years as teaching aids (PERS I) would become certified and move to TRS. Since PERS I was closed to individuals hired after 1977, the likelihood that 50-year-old government employees would begin new teaching careers is remote. Yet the original pricing run assumed that this would apply to all such dual members. The later runs were produced with a 20% scaling factor that reduced the cost to about .005. The State Actuary took exception to other assumptions that would have lowered the cost to a very small amount. Since the correction of the first assumption moved the cost to approximately 0, he did not need to have the other assumptions corrected.

ANALYSIS

The State Actuary's discussion of the problems with the original assumptions is a reasonable explanation for the various pricing runs.

CONCLUSION

While the underlying facts of the assertion have been substantiated, the reasons for revising the assumptions are reasonable. As such, no improper governmental activity has been identified.

ASSERTION

Please see note of February 16, 1997. Someone from OFM called inquiring about an early retirement package that included an incentive. In addition to an open window there would be additional benefits granted. The biennial cost, $75 million, was startling to Jerry. He said I should lower it to $25-50 million. Then he said I should not give the incentive to the older higher service members who were already eligible to retire. I mentioned certain federal laws required that it go to everyone. The person at OFM, a highly

skilled professional, insisted the bill be priced with essentially everyone getting the incentive.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower alleges the State Actuary improperly priced a proposal using inappropriate assumptions.

We interviewed the individual at OFM who was involved in this request for information. This individual confirmed the asserted conversation had taken place. It was an informal information request on a budget-related idea. OFM often asks for costs of proposals in an informal way. This did not relate to a fiscal note or any other formal communication. This individual was provided the $75 million cost for application to all eligible individuals as well as the $25 million cost for selected individuals. The range of $25 million to $75 million was presented and the proposal went no further.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Please see handout on TRS III transfer payment from the November 7, 1996 JCPP meeting. On page 2 towards the bottom the line titled "Combined Plan 2 & 3 rate" reads 5.8%, 5.9%, and 6.0%. For ten years this Office has maintained a policy that every fiscal note go out with a rate expressed as a percentage with two decimal points. By rounding to 6.0% it appeared to be close to the 6.03% in the line above. Not only should the value have two decimal places but if the number was rounded it should have been rounded to 5.9%, not 6.0%

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower alleges that using only one decimal place and rounding up instead of down misrepresented the impact of the proposed legislation.

The chart on page 2 of the handout was as follows:

Additional Payment:

	20%	30%	40%
Plan 2 Rate	6.03%	6.03%	6.03%
Combined Plan 2 & 3 Rate	5.8%	5.9%	6.0%

According to the whistleblower, it should have been:

	20%	30%	40%

Plan 2 Rate	6.03%	6.03%	6.03%
Combined Plan 2 & 3 Rate	5.78%	5.86%	5.94%

The combined rate increases for 1997-2001 are expressed as .1% to go from 20% to 30% additional and .2% to go from 20% to 40%. According to the whistleblower, it would have been more accurate to say that the combined rate increase for 1997-2001 would be .08% to go from 20% to 30% and .16% to go from 20% to 40%. While there is merit in being consistent in a presentation of this sort, we cannot believe the JCPP would have responded any differently had the costs been expressed as the whistleblower would prefer. This presentation is intended to provide a legislative committee with a feeling for the magnitude of the change being proposed. This is not the final determination of the funding requirement.

The State Actuary said there is no policy on fiscal notes that states amounts have to be shown with two decimal places. The only reason they express impact on contribution rates to two decimal places is because that is how DRS bills employers. In this case, the calculations were broad and they had no model to address all the pieces, so the calculation was imprecise. So going to two decimal places seemed to mislead users on the preciseness of the number when it is a generally stated number. This statement was made even though the current comparative contribution rate for Plan 2 was expressed in two decimal places.

We also found this presentation in the fiscal note for HB 1098 during the 1997 session, which is a departure from contribution impacts expressed with two decimal places.

ANALYSIS

While the presentation in the JCPP handout and the fiscal note is a departure from the usual OSA practice, there is no legal requirement to express contribution impacts to two decimal places. Rounding up instead of down does make the combined rate appear to be much closer to the current Plan II rate. As discussed above, the feeling of magnitude was communicated and the difference between using 1 versus 2 decimal places would not likely change the Legislature's deliberations.

CONCLUSION

The facts of the whistleblower's assertion have been corroborated. However, we have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Members of the House Appropriations Committee have been misled to facilitate the passage of JCPP-recommended bills. A recent example would be the change of the TRS III transfer payment from 20% to 40%. A legislator asked if there was going to be any debt passed on to future generations or if there was an increase in the Unfunded Liability. The truth is yes. The answer was no.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower alleges that the impact of the increase in the transfer payment on the unfunded liability was misrepresented during a meeting.

We obtained the audio tape of the House Appropriations Committee meeting where HB 1098 was discussed. We listened to pertinent sections of this tape several times. In this tape, a representative asked two questions that related to the unfunded liability. The latter of the two questions was very broadly stated, asking if the bill would have any effect on the unfunded liability or pass costs onto future generations.

The answer was this legislation would not increase an unfunded liability in TRS III or otherwise as result of this transfer. The question and answer asserted by the whistleblower have been fully corroborated by the tape.

The presentation of the same issue made to the JCPP shows an increase in the unfunded liability of $50 million. There is no unfunded liability on the TRS II and TRS III plans, which are funded using the Aggregate Cost Method. There is also an excess of assets over the value of accrued benefits (Projected Benefit Obligation for accounting purposes). We believe the increase in unfunded liability presented to the JCPP is the amount of additional assets to be transferred from being an employer asset to an employee saving's account. This is, therefore, an increase in the unfunded liability. But, one could also look at it as a reduction in unexpected surplus.

Certain of our interview subjects expressed discomfort over the way the State Actuary's definition of cost-neutral was not disclosed, the definition itself and the way the definition changed over time. This related to Plan III development where cost-neutral at one stage meant neutral within each of the TRS, PERS etc. plans, then, at another stage, it meant neutral when all plans are taken into account.

We obtained SHB 1206 from the 1995 session where the new Plan III was introduced. This bill, as originally introduced, showed a net cost to the general fund (savings from PERS and costs from TRS), but savings to non-general funds and local government employers. This bill was revised to reflect the elimination of the PERS members from the new plan and showed the same costs from TRS as had previously been presented. The TRS costs only impact the general fund. The fiscal note for HB 1098 from the 1997 session states "Contribution rates have already been set for the 1997-99 biennium under the assumption that Plan 3 would be cost-neutral with Plan 2." Since TRS impacts only the general fund, one could argue that the definition of cost neutrality by using the general fund as the criteria remained the same. However we can certainly understand why many individuals believe the definition changed over time.

The State Actuary stated that under the commonly used definition of *unfunded liability* the answer given at this House Appropriations Committee hearing was "no". Also under the definition of cost neutrality the answer was "no". Going from 20% to 40% spent the unanticipated savings, but kept the transfers cost neutral. He believes his response was appropriate.

ANALYSIS

There is no state law or other policies and procedures that defines the appropriateness of comments made in a hearing. We do not question that the State Actuary believes his response was appropriate. We also believe that a valid argument can be made that the answer given was not appropriate in the context of the question. Even though we believe a more comprehensive answer which included the unfunded liability information presented to the JCPP could have been provided, there are no statutes, policies or procedures controlling testimony at hearings.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

The transfer payment originally calculated for TRS 2 to TRS 3 was roughly 20%. The delays in getting TRS 3 enacted came in a period of great investments and other experience gains. The rate was later amended to 40%. When work was done for PERS recently there was constant pressure to find a way to make the PERS transfer payment 40% also. The numbers in PERS generated a much larger rate, so Jerry had me go back and change the length of the window involved, the amount on which the transfer was based, anything we could do and say it was a 40% transfer payment that would in reality be very close to an 80% transfer if made on a basis comparable to TRS 3.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower alleges that in an effort to make the transfer payment be the same for both PERS and TRS, the Actuary used techniques to make non-comparable transfers appear to be comparable.

We have accumulated several workpapers that are pertinent to this assertion as well as a few of those covered above. The creation of PERS III and TRS III out of PERS II and TRS II has been the subject of legislation for several years.

In the 1998 session, bills are being considered that would provide for "additional transfer payments" totaling 65% for both PERS and TRS participants. It has been resolved that this is cost-neutral to the general fund when the entire change from Plans II to Plans III is taken into account.

The State Actuary maintains that the intent, since 1992 when this change was first proposed, has always been to create the new plans without any change in general fund cost. It has taken several pieces of legislation to accomplish the changes. Some of those individual pieces of legislation, taken alone, show a fiscal impact on the general fund. We have discussed this process in more detail in the assertion above.

The difference of opinion between the whistleblower and the State Actuary has arisen over the presentation of these bills over a period of years. There

is plenty of room for legitimate difference of opinion. In the final analysis, the State Actuary must decide how such things are to be presented.

ANALYSIS

We are not entirely comfortable that the legislators understand how these changes are affecting future costs. We acknowledge that the changes are cost-neutral to the state's general fund. However, we believe that contributions to the Teachers Retirement Plans will increase -- the 65% additional transfer payment is larger than would be cost-neutral within the Teachers' plans. On the other hand, we believe that contributions to the Public Employees' Retirement Plans will decrease -- the 65% additional transfer is less than the amount that would be cost-neutral within the Public Employees Plans. In other words, the effect of making the transfer percentage the same between the plans is to lower future PERS employer contributions and to raise future TRS employer contributions.

CONCLUSION

We believe that the presentations have been forthright. Therefore, we have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

(a) The statement made to Senator Jacobson about cash flows at the June JCPP was not correct.

(b) Jerry was discussing the Volunteer Firefighters' Relief & Pension Fund (VFRPF) and on occasions mentioned their cash flow. To an actuary this is blasphemy, not one four letter word but two! A pension fund (unless it is teetering on bankruptcy) measures liabilities on a present value basis, not cash flow.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The core issue is the inaccurate and improper use of cash flow concepts in information presented to legislators.

We obtained the audio tape of the June 19, 1997, JCPP meeting. We were able to locate the alleged discussion. The discussion arose from a briefing of the actuarial process. Senator Ken Jacobson wanted some background information on why the year 2024 was selected for amortizing the unfunded liability. The State Actuary stated that it was a cash flow issue, that little cash will be going into the system as they approach 2024, but large outflows for benefit payments to beneficiaries will be experienced. He stated sufficient cash balances are needed at that time to make the benefit payments and by extending the amortization period past 2024 they would run out before the last retiree is deceased.

Based on our review of the whistleblower's June 19, 1997, note, the whistleblower believes the date could have been extended to 2030 and the cash flow would still be sufficient. The whistleblower believes the statement that they would run out of cash by 2024 was incorrect.

The State Actuary stated he wouldn't know what it was today, but he did as of 1989 because that is when the OSA did all the work on the new funding method and determined the year 2024. He admits it's not true that each plan would run out of money, but overall, in combination, the year 2024 worked. The year 2024 was established when it was 35 years away and he thinks 40 years would have depleted the cash if used as an amortization period. He stands by his statement that 2024 was picked on this basis. There is negative cash flow (excluding investment returns) in the plan now, which will continue.

The State Actuary stated that for assertion 33b the VFRPF have defined benefits as well as defined revenues, so cash flow is relevant and it would not be unusual to talk about cash flows in this plan.

ANALYSIS

A difference of opinion between the whistleblower and the State Actuary has arisen over the presentation of the importance of cash flows to the selection of the year 2024 for amortization purposes. There is plenty of room for legitimate difference of opinion. In the final analysis, the State Actuary must decide how such things are to be presented.

CONCLUSION

While the underlying facts of the assertion have been corroborated, we have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Please see notes of February 15 & 19, 1997. During the 1997 legislative session a bill came up that would allow Plan I members to cease making contributions in exchange for "freezing" their AFC at the amount attained at 30 years. Jerry objected to the fiscal note on the grounds that the long-term assumption for salaries of 5% was higher than recent increases. Using a 2% or 3% increase would develop more costs. I pointed out that statute required us to price bills with long-term assumptions. Not only was he ignoring the methods in statute, but Jerry wrote that section of (the funding) statute (RWC 41.45).

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The issue in this assertion is the pressure exerted by the State Actuary to use a short-term assumption when the whistleblower believes they were required to use long-term assumptions.

We obtained the OSA working file "Drop Contributions after 30 years, PERS I/ TRS I HB 1925 1997" and obtained the fiscal note which speaks of using the 5% salary increase assumption as well as the impact of using the 5% assumption. There was no documentation of the asserted objection contained in this file.

The State Actuary confirmed the assertion. He explained the Legislature capped the benefit at age 60. The employee either could choose to stop contributions or stop salary increases. He believes it to be inappropriate to analyze a short-term issue with long-term assumptions. The State Actuary and the whistleblower discussed the issue. The State Actuary does not believe the statute requires the use of long-term assumptions in fiscal notes, especially if it is contingent on the event.

After the interview with the State Actuary, we verified his statement about the lack of a requirement to use long-term assumptions in fiscal notes by reference to two sections of state law. The requirement to use long-term assumption is in the preparation of actuarial studies.

ANALYSIS

The 5% assumption was used and disclosed in the fiscal note even though the State Actuary did not believe it was necessary.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

There was another significant problem with the legislation. Some members would be better off under the new COLA, others would lose out under the new COLA. The universal standard of actuarial practice to compare benefits is the present value calculation. Using this accepted approach the more highly paid as well as virtually all active employees would be better off under the old COLA. Rather than use present values to compare the value of the two COLAs, a comparison of the payments was made by each COLA within 10 years of effective date of the act. Though convenient, this approach is without merit. If this were to be challenged in court, I would have to say it is an invalid way to determine whether or not we were harming the member by changing the COLA. Please see the attached.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The issue centers around the bill's language on what to do with the people who are allowed to use the old (COLA) benefit. The method established was to analyze who would get more over the next ten years (ten-year test). The whistleblower alleges that the ten-year test is inappropriate; the State Actuary is the one who developed this method, wrote the bill and advised that this was the best method. The whistleblower alleges that the method used to show how each employee or retiree is affected by the 1995 change in COLA misrepresents the actual effect. He says it is a universal standard of actuarial practice to compare benefits using the present value calculation.

One individual corroborated that the State Actuary came up with this standard. Concerns had been raised about not using an actuarial equivalent as an option to calculate COLAs, but the State Actuary stayed with his method in writing the bill language. He was in a position of writing the bill, assisting in bill passage and of being an actuarial advisor. DRS made a policy

that if someone wanted the old COLA they would give it to them because they didn't want to defend this method in court.

One legislator stated that the briefings and graphs clearly indicated that the new COLA was better for some and not for others.

The State Actuary stated the choice for people within the 10-year period is in statute (1995 session laws Chapter 345, Section 13), and he was merely following statute. This was a legal issue; the OSA met with a DRS attorney and a representative of the AGO. There was a collective decision to use the 10-year method). Since most of the benefit would be derived within this ten-year period, the State Actuary believes it is more relevant to retirees.

ANALYSIS

To communicate the effect of the changes, a comparison was made of the total benefits payable during the next 10 years on the old and new basis for those who were already retired. There is no question that actuaries would consider present values to be best for making such comparisons. That does not mean that actuaries do not find it practical to make presentations using other methods that they consider more understandable to their audience. Simplifications should not distort the facts. This 10-year approach presented a single sum value of the old and the new COLAs. So would a present-value approach. We do not understand how this approach made the presentation more understandable. So, it may have been done to make the new benefit appear better to more retirees.

While we find the explanation given by the State Actuary to be lacking in certain respects, we believe this situation is, once again, a difference of opinion between the State Actuary and the whistleblower.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

Interpretation of State Laws

Summary and Recommendations

Interpretation of state laws is necessary in any government agency. We have found no improper governmental actions related to the OSA's interpretation of state laws.

From a business perspective, management, who is accountable to the shareholders of a company, often needs to pursue clarity of regulations in the conduct of the business. They will choose whether to pursue such clarification with the administering agency, in the legislative arena or through the court system. We believe this model also is appropriate for public officials who are accountable to the state's stakeholders.

The three assertions contained in this section warrant such pursuit of clarity. These issues have varying degrees of risk to the state and should be addressed in a wise and judicious manner. We recommend:

- DRS and OSA should report significant implementation issues to the JCPP. DRS and OSA should collaboratively develop recommendations to solve such issues.

- The Legislature should change its tone to DRS and OSA from not wanting to hear about implementation problems to asking for recommended solutions to significant interpretation issues.

Assertions

The following are the assertions that raise concerns regarding interpretations of statute.

Agencies may have to interpret statutes in order to implement them, but they may not modify or amend a legislative enactment. However, we have found no statutory or regulatory requirement which compels agencies to request the Legislature to correct or clarify language in statute. In making our recommendations above, we used customary business practices as the criteria.

ASSERTION

Please see attached handout on TRS I benefits with and without withdrawn contributions. The factors used in this calculation do not comply with statute. I calculated the required factors twice, once according to statute, once according to Jerry's specifications. I refused to sign a letter to DRS that would be accompanied by the wrong factors. The cost of correcting the benefits, and making up past under-payments is somewhere around $150 million. If this was corrected for currently employed members, there would be an additional cost of about $200 million if the interest rate continues at

7.5%. If economic assumptions are changed and the investment assumption does go to 8.0%, the amount would increase even more.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The whistleblower alleges that the State Actuary made an incorrect interpretation of statute when calculating withdrawn contribution factors.

We obtained the OSA correspondence files for 1989, 1990, 1991 and 1992 and searched the index for any correspondence related to TRS. We were especially interested in correspondence that discussed option factors or early retirement factors. We scanned all relevant correspondence in search of information pertinent to this assertion. We found no letter on this subject from the State Actuary, but did find four items on somewhat related items signed by another individual. Two of these items reflect an interest factor of 7.5%.

After several discussions and much searching through files, we believe the following summarizes the problem:

1. All actuarial equivalency factors have, for many years, used a 7.5% interest assumption.

2. Employee contribution accounts have, for many years, been credited with 5.5% interest.

3. The Revised Code of Washington states:

- 41.32.010 (1)(a) "Accumulated Contributions" ....with regular interest thereon.
- 41.32.010 (2) "Actuarial equivalent".... basis of such mortality tables and regulations as shall be adopted by the Director and regular interest.
- 41.32.010 (23) "Regular Interest" means such rate as the director may determine.
- 41.32.480 uses actuarial equivalent to convert contribution accounts to annuities and determine early retirement benefits.
- 41.32.530 Options available .....actuarial equivalent of his or her retirement allowance.
- 41.32.498(2) ....Provided, that any member may withdraw all or a part of his or her accumulated contributions,...,a reduction in the standard two percent allowance, of the actuarially determined amount of monthly annuity which would have been purchased by such contributions.

4. The Director has determined that regular interest for determining accumulated accounts is 5.5%. But, regular interest for determining actuarial equivalents is 7.0% or 7.5%. The whistleblower is raising this contradiction

with respect to the participant's right to withdraw his or her account and take a smaller pension.

Based upon our review of the file discussed above, it appears to us that the Director has also determined that something which is "actuarially determined" should be calculated on the same basis as things that are determined to be "actuarially equivalent."

Based upon interviews, DRS didn't know this was an issue until two or so years ago. DRS understands the problem with the statutory language. It could be read to require actuarial equivalency (at a 5.5% rate) or could be read to say that the term *actuarially determined amount* was intended to be different from actuarial equivalent. If legislative intent could be located, it would help solve the ambiguity. Because of the ambiguity, however, it would be difficult to say the OSA did something wrong in using 7.5% in its option development.

The State Actuary stated the set of statutes relating to these calculations evolved over time and are ambiguous at best. This specific issue relates to the pre-1974 plan, which had a defined contribution portion and a 1% defined benefit portion. The old retirement boards would set the interest rate to be credited to member accounts. Then the state moved to a 2% defined benefit plan only, so the issue about member rate was not relevant to benefits. Apparently, a decision was made that the rate for actuarial equivalence was to be different than what was credited to member accounts. The State Actuary stated this issue has been openly discussed with DRS, OSA staff and with the AG. With 25 years (long standing administrative procedure) of doing this a certain way, he was not going to change the process.

The State Actuary said the whistleblower never challenged this practice. Even if the issue had been raised, the State Actuary believes they would have ended up in the same place because they couldn't do anything about it. He believes submitting a bill to clarify the law would establish that a change was being made. While such a change would solve this issue for future employees, the Bakenhus[2] court decision may have caused a problem for the state with current employees.

ANALYSIS

The decision to make a change in how these options are calculated could have potential consequences to the state. We believe the decision to not make a change was justified. However, we take exception to the State Actuary and other state agencies not pursuing an appropriate resolution, if one should exist.

CONCLUSION

[2] Bakenhus v. City of Seattle, 48 Wn.2d 695, 296 P.2d 536 (1956). This case provides that an employee who accepts a job to which a pension plan is applicable, contracts for a substantial pension and is entitled to receive the same when prescribed conditions have been filled. His pension rights may be modified prior to retirement, but only for the purpose of keeping the pension system flexible and maintaining its integrity

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Please see note of December 9, 1993. Earlier today Jerry and I discussed the administration of recently passed HB 1744. The bill allowed officers at U.W. and the ports (who were members of PERS) to move to LEOFF II. In the past, as PERS employers, they had contributed to both the PERS Plan II normal cost as well as a PERS I supplemental liability payment (about 5% and 2 1/2%). The old LEOFF II rate would have been about 7.6%. They will be required to make up the difference. The bill language was not specific and it could be interpreted that the employer receive credit for either 5% or 7 1/2%, thus they would have to pay either .1% or 2.6% (I am simplifying here, but the point is made). Jerry said, "Makes you want to gouge them. If they come in asking for a pig in a poke they deserve anything they get. It's okay to overcharge them."

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

This issue involves an interpretation of statute made by the State Actuary based on his alleged disapproval of the legislation.

We reviewed the state law providing for the transfer, the related fiscal note and the workpapers related to the actual transfer. We also reviewed correspondence files when the additional amount to be paid by the employer became controversial.

The statute requires that employer contributions attributed to the transferring employee be transferred from PERS to LEOFF trust funds. These employees are in PERS II. PERS II employers make a supplementary contribution based on their pay to PERS I to fund the unfunded liability. The LEOFF II plan has greater benefits than the PERS II plan and therefore costs more. The employer of transferring employees must make up the difference in cost not covered by transferred contributions.

The whistleblower asserts the State Actuary improperly determined the supplementary contribution to be made by the employer to PERS I could not be transferred from PERS I and was not to be taken into account in determining the additional amount to be paid by the employer. We have corroborated that such a position was taken by the OSA.

The State Actuary says he did not make that determination. He says DRS determined what contributions would be transferred and the OSA did its calculations on that basis.

ANALYSIS

We have obtained sufficient evidence to conclude that while the State Actuary makes the case that DRS has the responsibility to make these interpretations and it is the entity which maintains employer and employee contribution accounts, the State Actuary does make these types of interpretation of statute and he did consult others on his interpretation of this specific matter. Agency directors are often placed in a position to make interpretation of

statute and we are unaware of any law or regulation that would prohibit the State Actuary from doing so.

CONCLUSION

The underlying facts to the assertion have been corroborated. The bill is unclear and OSA did interpret the bill to not give employers credit for PERS I supplemental contributions.

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Please see note of January 5, 1994. On more than one occasion we have drafted new language and found that a conflict arose when old language from another plan was used as a model. If we cleaned the language in the new plan, then the conflict in language would highlight the problem in the old plan. Rather than open up a can of worms, the problem is perpetuated. In this case we were discussing the employee's right to return to work in Plan III, and how it was administered for Plan II. Other examples would be membership for Union Representatives and the 3% COLA in PLAN II and PLAN III.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

This issue relates to the inattention by the State Actuary to administrative issues caused by unclear statutory language.

We believe one of the relevant laws referenced in the assertion involves the 3% COLA issue. Plan II COLAs would have been an easy change. DRS is administering a (up to) 3% COLA on the base retirement amount each year. This is different from the statutory language from a very technical reading of the statute. DRS believes that the legislative intent was to grant a cost-of-living adjustment not to exceed 3% each year. We read RCW 41.40.640 noting that limitation (c) relating to the annual adjustment states that in no event shall the annual adjustment "Differ from the previous year's annual adjustment by more than three percent." Based solely upon our interviews, DRS may not be in technical compliance with the administration of the Plan II COLA, but they believe they are following the statute's intent.

The interviews are consistent in that these issues have been raised among DRS and OSA staff and that the State Actuary does not support changes in statute for administrative purposes. However, these interviews do not directly tie these issues to a decision made by the State Actuary.

Current and past OSA staff made several general comments which provide insight to the prevailing attitude of the Office. The standard reaction to requests by DRS to fix language in new bills when they conflict with the existing plans is to not address the issue. The legislators want to be in a position to say that the participants selecting a new plan will receive no

change in benefits. We were told that the legislators don't want to hear about minor changes to correct old problems because the bill won't pass. This type of situation frequently happens. Most people recognize that a bill is not perfect, but from a practical perspective, it is what will get passed. They don't believe that the OSA ever attempted to go back to a bill and clean up language in subsequent sessions.

The State Actuary stated this happens all the time. They could spend their entire life clarifying statutory language. He does not deny the assertion. However, he stated that OSA never writes statutory language without conferring with DRS on these issues. They work closely with DRS if the change would impact DRS and they do what DRS wants.

ANALYSIS

One of the examples provided in this assertion is a situation where the administration of a COLA may not be in conformity with statutory language. We believe this situation warrants attention as a sound business practice. We are sympathetic to the inability to fix all language problems, but believe the whistleblower has raised issues that deserve attention. However, we are unaware of any law or regulation which would compel the State Actuary to undertake the request for statutory revision.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

Involvement in External Processes

Summary and Recommendations

No improper governmental activity was established for any of the assertions regarding the State Actuary's involvement in advocating certain legislation.

Assertions

The following assertions raise concerns regarding the OSA's involvement in other state processes.

We have considered the following criteria in the conduct of this portion of our investigation. RCW 44.44.040 sets the powers and duties of the OSA. RCW 41.45.030 lists assumptions which are adopted by the Economic and Revenue Forecast Council (ERFC).

ASSERTION

Please see notes of April 1, and April 9, 1997. Our Office has taken the position of "working bills". Is this the role of the Office of the State Actuary?

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The core issue in this assertion is whether the State Actuary engaged in advocating certain legislation.

RCW 44.44.040 contains the powers and duties of the OSA. These duties include performing actuarial services for DRS and the Legislature; advising and consulting with the Legislature and Governor on pension benefit provisions, funding policies, investment policies of the State Investment Board and determining the actuarial assumptions used by DRS; providing staff assistance to the JCPP; and preparing fiscal notes.

The eight Senators and Representatives interviewed were consistent in their discussion of the appropriateness of the level of "staff support" for the JCPP in the legislative process. Not one individual expressed concern that the level of involvement by OSA in the legislative process was inappropriate. However, it should be noted that these individuals expect the OSA to support the JCPP position on bills in political discussions with bill opponents. The OSA was described by one individual as being very helpful in taking JCPP's general ideas and providing the detailed means, tools, procedures etc., to accomplish the JCPP objectives.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Please see note of August 29, 1995. Jerry decided that the new economic assumptions should be 8.0%, 5.5%, and 4% for investment, salary increases, and inflation respectively. After he decided the rates, he asked me to do research to support the decision. Some would do the research prior to the decision making.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

This assertion implies the OSA has advisory responsibility only, that deciding the assumptions up front in developing the information to be an inappropriate involvement in the long-term assumption adoption process.

We reviewed the relevant statute, specifically RCW 41.45.030, and the following assumptions are adopted by the Economic and Revenue Forecast Council (ERFC):

- Growth in system membership
- Growth in salaries exclusive of merit or longevity increases
- Inflation
- Investment rate of return

The State Actuary stated he agrees with this assertion. He stated he must support the ERFC in its decision process. He did ask the whistleblower to run the valuations at 8% so he could be prepared for the meeting of the ERFC. He thought that the council might ask for it.

The Director of the ERFC confirmed that the State Actuary does not inappropriately influence the ERFC processes in the development of long-term assumptions.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

After investments have a great run up, two things generally happen: first, those who have a vested interest begin to get excited and their expectations grow, and those with more detachment recognize mean reversion. Mean reversion is a tendency to revert to the trend-line. Though this principle is thoroughly understood and even espoused by the State Actuary, he has spent much of the last 6 months planning to have the investment return rate increased to 8.0%.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

We believe this assertion is the same as the next series of assertions.

ASSERTION

(a) Please see note of April 11, 1997. Jerry mentions the investment return assumption should be raised to 8.0%.

(b) Please see note of May 29, 1997. Jerry discussed changing economic assumptions. He did not say, "Investment return is assumed to be 7.5%, what might happen if it goes up or down a half a percentage point?" However, he did say to run some valuations at 8.0%. He had mentioned this many times previously.

(c) Please see note of June 11, 1997. Jerry says the investment return rate should go up to 8.0%. No research has been done. No studies have been made.

(d) Please see note of June 19, 1997. At the Joint Committee on Pension Policy meeting today, Jim Parker, Executive Director, Washington State Investment Board, said they had a short-term (was it five years?) prediction that markets would average 5% annually. Jerry again says the investment assumption should be raised to 8.0%.

(e) Please see note of June 22, 1997. Jerry is anticipating the 1998 Legislature. They will see valuation results indicating lower rates and will want a "pension grab" as they did in 1993. He would prepare by having us cost various proposals for all the interest groups so that we could pass around the savings. The savings would be increased by changing the investment rate to 8% which lowers contributions.

(f) June 30, 1997. Jerry told me interest rates were going to go up to 8% (assumption of investment return) and this would lower contribution rates. We have to be ready for this by preparing costs for lowering the retirement age of Plan II.

(g) July 2, 1997. In reference to the Economic & Revenue Forecast Council, Jerry said with resignation, "We may not be able to be the drivers. We may not be the determiners. We may just do the inputs."

(h) July 3, 1997. Jerry asked me to run valuations using an 8.0% interest rate assumption. He said the Legislature is going to want to take the $100 million for the difference between the contributions required by the 1995 valuations and the 1996 valuations. Additionally, rates were going to go up to 8.0%, so there might be another $100 million drop.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

We believe the core issue in this series of assertions is the same as the previous two, that being the manipulation of the Economic and Revenue Forecast Council decision and acting as an advocate versus an advisor.

One legislator stated that the discussion of interest rate assumptions is not unusual; the present four-year average is over 13% and the rate had been above 8% in the past.

The State Actuary stated the ERFC adopted 7.5% in December, 1997. He confirmed that 8% was his opinion for what the long-term rate of return

should be. He stated no research and studies had been done by the whistleblower. His research indicated 8% and over is the average for public plans, and asset allocation is much more aggressive now (70-30 equity/fixed mix) as compared to the (60-40) mix when 7.5% was first adopted. He believes he did sufficient research to properly suggest that 8% be used.

The Director of the ERFC confirmed that the State Actuary does not inappropriately influence the ERFC processes in the development of long-term assumptions.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

I called Bob Bramlet at GASB to determine whether Plans I and Plans II should be treated as one plan or two. (The combining of the poorly funded plans I with the well funded plans II would create the impression of a moderately funded system and mask the underfunding). I mentioned that Mr. Bramlet said we had to split them. Jerry said, "fortunately he isn't going to be the one making the decision" - - Bob Bramlet wrote GASB 5.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The core issue is the decision of the State Actuary to combine plan information to hide underfunding.

We selected the state's comprehensive annual financial report (CAFR) for the year ended June 30, 1994 and noted that Plans I and II are combined for the purpose of disclosing the unfunded pension benefit obligation and for the required analysis of funding progress. This disclosure states this information is stated for each system. While GASB 5 defines the disclosure requirement for each PERS (a system), it also contains a discussion that a plan-by-plan disclosure is intended.

We also noted the GASB clarified its position in GASB 27 by stating disclosure requirements in terms of "Plans" instead of "Systems". We noted that the state's 1997 CAFR discloses funding progress by Plan as is required by GASB 27.

It is important to note that the OSA, while supplying information for the CAFR, is not necessarily the only entity responsible for this information. OFM as the preparer and the State Auditor's Office as the auditor all have respective responsibilities regarding the CAFR.

The State Actuary stated he doesn't recall making the asserted statement. He stated OSA and OFM make the decision, that it didn't mask underfunding and the individual plan amounts were disclosed in the OSA valuations.

An individual at OFM confirmed that he had made the decision to combine the plans in the CAFR footnote disclosure in consultation with others at OFM. It is within OFM's authority to make such accounting interpretations.

CONCLUSION

We have determined there is no reasonable cause to believe that improper governmental activity has occurred.

ASSERTION

Please see notes of May 23, the note of May 29, and the attached subpoena. The AGO was defending DRS and one of their attorneys asked me to appear. Normally my testimony is in written form and the lawyers argue legal points rather than my calculations. However, in this particular case, the plaintiff's lawyers insisted on cross-examination. When the date was set and Jerry was notified, he insisted that the Judge change the hearing date or that I not go. Upon hearing this, the AGO issued a subpoena for me to attend the hearing. Jerry told me he was going to call the AGO as they had no authority to issue a subpoena.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The core issue is the inappropriate exercise of control in this hearing process.

We obtained the e-mail instruction from the State Actuary, instructing the whistleblower to say the date was unavailable. We also obtained a copy of the above-referenced subpoena.

We discussed this issue with the representative from the Attorney General's Office who confirmed that the whistleblower had been asked to appear to testify in one of their cases. The whistleblower communicated that the State Actuary thought there was a conflict with a hearing date. To help the situation, this individual issued a subpoena. The State Actuary was effective in delaying the testimony date, but this individual confirmed that the whistleblower did testify on this issue at a later date. This individual positively stated the State Actuary did not insert himself into the testimony process to replace the whistleblower.

The State Actuary stated they had an all-office meeting with an outside consultant on the day requested. The conflicting appearance request wasn't for a court appearance but at an administrative hearing. He asked for him to rearrange the hearing date so that he could attend the office meeting. The next day the subpoena arrived, he took it to DRS, who apologized and rescheduled the hearing. He doesn't know if the hearing subsequently took place.

CONCLUSION

The State Actuary's interview is consistent with both the documentation reviewed and the interview from the AGO representative. We have determined there is no reasonable cause to believe improper governmental activity has occurred.

Work Environment

Summary and Recommendations

Two of the assertions in this section have been substantiated. However, we have no legal criteria by which to conclude improper governmental activity has occurred.

We have also found certain procurement behavior that is not customary and usual for a governmental organization. Other assertions regarding work environment were not substantiated.

The OSA has experienced significant staff turnover in the last few years. Those who have left hold a strong belief that the OSA work environment is inappropriate. Those who remain are less likely to express such thoughts.

Because it is within the legislative branch, the OSA is not bound by civil service requirements or other conventional means that protect the interests of employees when issues are not resolved with the State Actuary. The Executive Committee of the JCPP has instituted a new grievance policy for employees to allow them to bring such issues to the Executive Committee. While this is a step in the right direction, it is not viewed by employees as a "safe" way to express grievances. As staff to the JCPP, OSA employees are not managed in a similar way as other legislative committee staff.

We recommend that:

The OSA environment could use expertise such as that provided by the Department of Personnel. However, given that the OSA is a legislative agency, we are not aware of how this might be accomplished.

Assertions

The following are the assertions which we believe raise concerns regarding the work environment or other administrative activities.

We believe the portions of previously covered assertions regarding favoritism are best covered in this section instead of the bias in information section. We found wide differences of opinion on this subject.

Several individuals confirmed the State Actuary clearly liked or disliked certain legislators and that these feelings were openly expressed among staff. They stated it was obvious that work for favored legislators took priority since the work was timely and of high quality. For those not held in high regard, the requests were either ignored or were not subjected to full scrutiny Their bills received very little attention. A few legislators believed this to be the case.

A few individuals stated they were unaware of anyone that the State Actuary did not like and that he treated all legislators with respect. These individuals

would agree that inside the OSA, they joked around about certain characteristics of individual legislators, but they were never told not to do work because it was not important. Certain legislators are more demanding where others are less demanding. Most legislators believed this to be the case.

The State Actuary is forceful in his denial of these charges.

Given that the OSA's priorities are established by the Executive Committee of the JCPP, that the OSA experiences session-related pressures and that legislators are discussed within the office, we can see how different perceptions of the same situation could occur. For certain individuals, the OSA work environment is inappropriate. Others find it acceptable. Other than to recommend that the State Actuary be aware of how his actions and statements may be interpreted by his office and other agency staff, we cannot make any other conclusions or recommendations.

ASSERTION

Please see notes of June 13 & 14, 1995. Jerry would withhold information to punish DRS. In this case information for DRS for use in implementing the "Pop-Up" was available two weeks in advance and we were ordered not to send it.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The issue of this assertion is the purposeful neglect of another agency's information needs.

One interview subject confirmed that the information had been prepared for some time prior to being sent to DRS. This individual also confirmed that the delay was with the State Actuary, but did not know the cause or purpose of the delay, or its impact. This individual could not confirm any motivation behind the delay.

The State Actuary stated that developing option factors takes time, the whistleblower had completed the option factors, they had a deadline, he wanted to look at them and they made the deadline. The State Actuary would have no motivation to "punish" DRS.

An individual who was with DRS at the time does not recall any problems encountered because of a delay in the availability of pop-up information.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

See note of July 19, 1994. Representative Helen Sommers had asked us to consider an approach to excess compensation. Excess compensation has been an administrative nightmare for years. There was a history of legislation attempting to address the issue, but when self interest was involved people continued to find a way around the rules. Representative

Sommers' idea was quite creative. Variations of this approach had been repeatedly brought up by Dr. Hollister and myself. Jerry did not want us to pursue the topic and respond to Representative Sommers. (Dr. Hollister was a previous DRS Director.)

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

This assertion involves the inappropriate exercise of control over content of pension-related matters.

Representative Sommers had no recollection of this specific issue. Over time, many ideas and questions are raised as a normal part of the process. Representative Sommers believes the assertion is flawed because at no time has there been any resistance to ideas and questions or providing support. She believes that OSA has always been responsive.

An interview subject did not know about this specific issue, but stated it was common to be instructed by the State Actuary to not pursue certain issues. He had his own way to pursue issues and was not open to other ideas. This person also stated the State Actuary should have the authority to make those kind of decisions.

Another individual stated disagreement with the decision to not consider the excess compensation proposal.

Another person interviewed confirmed that the excess compensation issue was “stonewalled” but that it was a very complicated issue and that it was probably a wise decision to not take on the task to fix the problem.

The State Actuary stated he is not sure that the assertion is true. It would only be an allegation if Representative Sommers said it was. It’s a complicated issue and got bogged down. He worked with Representative Sommers on addressing specific pieces, but not the whole issue. What they have done has worked.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

A recent example might be from the most recent executive committee of the JCPP. The issue of a Cost of Living Adjustment (COLA) for members of the Judges Retirement System was raised. The Judges System has other problems that could be dovetailed into one bill and we could take care of several things in one effort. It was recommended that one option taken to the JCPP be the transferring of judges from their system into PERS I where members automatically get the "Uniform COLA". Some advantages of this would be 1) they get a COLA, 2) it is hard to argue for a larger COLA when this is what is given to the largest group of retirees in the state, 3) an underfunded system would have a more stable funding method, 4) DRS and OFM would have one less fund to deal with and there would be associated administrative cost savings. We were not to put that on the table.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

This assertion involves the inappropriate exercise of control over content of pension-related matters.

One individual stated the comment about not having the issue on the table is not true. This individual worked on that issue and found it was a bad idea because either no one would qualify or there was no interest from the two active members in participating. This individual's experience was that the proposal was on the table and it was investigated.

Another individual does not know about this specific issue, but stated it was common to be instructed by the State Actuary to not pursue certain issues. Mr. Allard had his own way to pursue issues and was not open to other ideas. This individual also stated that the State Actuary, as the head of the organization, should have the authority to make those kind of decisions. In other words, not being open, while it may cause ill feelings, is not necessarily inappropriate.

The State Actuary stated he did make this decision because it was a very bad idea. It couldn't be administered because they all have different benefits.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

See letter of August 13, 1990. Amounts in Plan I vs. II were all wrong. My assignment was to find out why. After finding out why, nothing was done because there was no desire to rock the boat. (Eventually separate trust funds were created - but no improper transfers were ever reversed.)

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The core issue is the instruction to not inform others of a necessary correction.

We understand that all funds for PERS, TRS and LEOFF were in one plan, with an accounting to segregate the assets between plans. The unit value was not refreshed on a timely basis, causing purchases in Plan II to be made at the old rate, resulting in improper asset allocation between the plans. The whistleblower alleges that he was told to not disclose the error to DRS.

We obtained the referenced letter of August 13, 1990, which is an intraoffice memorandum. This memo provides additional details regarding the impact of the mark-to-market issues. When investments are valued at market (as opposed to their original cost), certain issues of when the market revaluation takes place and the valuation method used can affect the values credited to plan accounts.

Neither staff nor the State Actuary could recall this specific incident. It appears in this case that the investment accounting error didn't impact the valuation.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

When John Charles was hired as Director of DRS there was a mistaken impression that he was black. Jerry made several remarks, referencing him as singer Ray Charles' cousin, etc. An OSA employee specifically referenced laws about human rights and said that kind of talk was not allowed. Jerry said "Those don't matter."

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The core issue is unprofessional behavior and the disregard for human rights laws.

Two individuals confirmed this assertion is factually correct, although one could not recall whether the statement that human right laws don't matter was made. These individuals believe this is just one example of unprofessional behavior exhibited at the OSA.

The State Actuary denied making this statement.

CONCLUSION

While the assertion has been substantiated, we have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

(a) At the May meeting of the JCPP executive committee the OSA budget was discussed and the awarding of a contract for review of the fiscal notes was mentioned. Representative Sommers was aghast that a contract be awarded for the form or appearance of fiscal notes. She believed they had to be auditing the numbers. Jerry said the were doing more, they were auditing. Sandi Granger, who reviews the contracts as part of her duties as Office Manager knew the contract specifically excluded any review of the numbers. She blurted out "AUDIT?" And suddenly realized she was on thin ice.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The core issue in this assertion is that the State Actuary misrepresented the nature of this contract in a statement made to the JCPP Executive Committee.

We obtained the Milliman & Robertson, Inc. 1997 personal services contract file and read the RFP, the scope section of the contract and the consultant's report. All three of these items support that the contract was for a review of the "approach, format, style and techniques of communicating fiscal impact." This means that no audit work was done.

One individual confirmed the details of the assertion were true.

None of the Executive Committee members interviewed recalled this discussion from this meeting. A few members stated that since the contract was for a small amount (approximately $10,000), the expectation of an audit would be very low.

The State Actuary stated he did not represent that there was auditing activity in this contract. He never used the word audit and didn't intend to deceive anyone about this.

ANALYSIS

We have direct and specific corroboration of the assertion from one individual who attended the meeting. None of the legislators interviewed recalled this discussion from a meeting held less than a year ago. We have found that information from the individual who corroborated the assertion exhibits balance. As a result, we will necessarily place a higher degree of confidence in the direct and specific corroboration than the lack of recall by other individuals. Even though we believe that this misrepresentation did occur, this situation is mitigated by information in the meeting packet which described the contract and that the legislators indicated that they were aware of the small dollar amount of the contract. Therefore, we do not believe that the misrepresentation had any impact.

CONCLUSION

While the assertion has been substantiated, we have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

(b) Jerry had asked me to write the Request for Services proposal. Checking the numbers was excluded from the beginning. It was technically not an audit but a review so Jerry could exercise more control over the project. The intent from the beginning was to obtain a letter that could be waived in front of the Joint Committee on Pension Policy to indicate the OSA was okay. The concern about content was secondary at best. When the consultant produced a detailed letter he complained on three separate occasions. Each time he made a comment along the lines of "We just need something that says we're doing okay."

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

See procedures under assertion (a).

The State Actuary stated the RFP stated this was not a contract to audit. He didn't bully the consultant; he responded to his concerns for information

sufficiency. It was an interactive process; he wanted to separate actuarial vs. fiscal impacts.

We interviewed the contractor for this engagement. She recalled receiving very little input from the State Actuary on her recommendations. She felt no pressure to change her findings or otherwise reduce the content of her report.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Upon completion of our 1989-94 experience study, a contract was awarded for an audit of our work. Norm Losk, who was Jerry's first boss here, had just started his own business and Jerry wanted him to get the business. Jerry assembled a task force to oversee the selection process. He then picked several people he knew would be rejected for various reasons. Ed Friend did a lot of work in the public sector and Jerry said Sheryl Wilson (former director of DRS) particularly disliked him. Others were solicited because they were very expensive. Jerry told Norm Losk what the other bids were coming in at and he underbid them. This allowed Norm to get the business.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The core issue is an inappropriate procurement process.

We obtained the personal services contract file for this Losk engagement. We reviewed the "Experience Study Audit, Consultant Evaluation" forms contained in this file.

We also obtained the task force file, noting that the request letters for participation went to agency heads and, except for one agency head, other participants were determined by the other agencies.

We interviewed all of the individuals who had served on the task force. These individuals do not remember being pressured to chose a certain firm. They were swayed, however, by the strongly expressed opinion of the State Auditor and others on the task force.

We expanded our review of other contract files for the purpose of establishing a pattern, or lack thereof, in contracting. We selected the next most recent contract which was for the LEOFF I Retiree Health Care Benefits Liability Study performed by Milliman and Robertson in 1994. The OSA received proposals from four firms and received letters of declination from four other firms. The file contains evidence, such as publication notices in Spokane and Seattle news publications, that this procurement was advertised. Two separate evaluation forms were contained in this file, but the evaluators

were not identified. Three of the four firms received very similar marks, but both evaluators marked M&R as the highest rated firm.

We also obtained a contract to develop an RFP for a LEOFF medical benefit study. This contract was granted to Milliman & Robertson. It appears that the firm hired to develop the RFP eventually was awarded the contract for the services resulting from the RFP. This has the appearance of a conflict of interest. We have been informed that there are no procurement rules for legislative entities which would prohibit this activity.

Because this additional contract file contained evidence of a process which, in our experience, is customary and usual, a pattern of "rigging" procurements does not appear to exist.

The State Actuary stated this was a customary procurement (contract for a review) at the end of a valuation. All responses received were good and they went to the selection committee. He didn't control the review committee since he didn't vote and others on the committee were not selected by him. Responses normally come in the last minute, so there wouldn't be an opportunity to tell Losk the fee. Mr. Losk had not previously been involved with State Actuary contracts and had been away from the office for many years.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Jerry arranged an appointment in Wyatt's Chicago office to discuss Asset Liability Matching despite Wyatt's having an office in Seattle. He said he was going to have the state pay for his visit to his sister.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The core issue is the inappropriate use of state travel funds.

The whistleblower asserts that not only did the Seattle office have the expertise, but the Chicago office could have come to Washington State for this meeting. This was different from the normal mode of operation. Consulting actuaries always held meetings in Olympia.

We obtained the travel files for the State Actuary from 7/91 to 6/97 noting no claims for travel to Chicago during this time. We also obtained the American Express Corporate Travel account statements for the 95-97 biennium noting no Chicago travel for the State Actuary. We were told the corporate travel account was not established prior to the 95-97 biennium.

One individual stated the alleged trip was made, but the state may not have paid for it. A trip was made to research computer systems used by actuarial firms. This individual did not hear the alleged comment about the state paying to visit his sister.

The State Actuary stated he did make one trip to Chicago to visit the Wyatt office to review software. He went to many different firms for this purpose. All systems reviewed were expensive and he didn't buy any. He did stay with his sister to save the state a hotel room charge. The Seattle office of Wyatt was not big, so he probably had to go to Chicago to talk to someone who could address his concerns.

Apparently this happened prior to 1991, because he had some difficulty remembering when this happened and because we did not find any expenses for such a trip from 1991 to 1997. Based upon the pattern established in the following assertion of not traveling frequently (we noticed very few travel incidents from 7/91 to 6/97), we don't believe that any follow up is warranted.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

ASSERTION

Jerry was discussing the budget with (another OSA employee) and I, in particular travel to professional meetings. Jerry said he had looked at a map and realized he had never gone to Alaska so he should find a meeting there. That summer he went to a conference for teachers retirement systems in Alaska.

PROCEDURES EMPLOYED AND EVIDENCE OBTAINED

The core issue is the selection of conferences based on location rather than content. As such, the inappropriate use of state travel funds is alleged.

We obtained the files for all of the State Actuary's travel from 7/91 to 12/97. We noted that during this time Mr. Allard had traveled to the National Conference on Teacher Retirement in 9/91, 9/92, 10/93, 10/95 and 10/96 in various locations around the country (including Puerto Rico). We noted no state-paid travel to Alaska during this time period.

We also obtained the American Express Corporate Travel account statements for the 95-97 biennium noting no Alaska travel for Mr. Allard. We were told the corporate travel account was not established prior to the 95-97 biennium.

One individual was not involved in a conversation like that alleged, but stated that the State Actuary went to Alaska in 1989 for the National Conference on Teacher Retirement (NCTR), a conference to which he typically goes. This conference is seen as more valuable than other options because other people from the state go (DRS). They also have broad content, better than some other types of conferences.

We obtained a listing of all past NCTR meetings noting the 1989 meeting was held in Anchorage. This individual's testimony has been corroborated and,

as such, we did not need to obtain 1989 travel documentation to determine that the travel did occur.

Based upon our investigation of travel expenditures from 1991 to 1997, we have established a pattern by the State Actuary of attending these meetings and we did not find any unusual or suspicious travel in the files. We believe the evidence is sufficient to conclude that this travel to Alaska was customary and usual.

The State Actuary said he went to Alaska and he routinely goes to the NCTR meetings. He doesn't remember the conversation contained in the assertion.

CONCLUSION

We have determined there is no reasonable cause to believe improper governmental activity has occurred.

Conclusions and Recommendations

We have concluded our engagement, finding little to cause concern with respect to the soundness of the pension systems. Concerns over the strength of the pension system should be separated from issues arising in the management and organization of these systems.

System

We believe the following statements are warranted as a result of our investigation.

- The funding of the state's pension systems is stable.
- The JCPP executive committee and the OSA, in closely coordinated actions, have considered many proposals over the years and they have been handled in a fiscally responsible manner.
- The Unfunded Accrued Actuarial Liability of the plans closed in 1977 is being systematically funded to the year 2024.
- There is no unfunded liability in any of the plans established subsequent to 1977.

These comments need to be tempered by the reality that the contributions required to maintain systematic funding may become onerous if:

- Inflation or investment performance is unfavorable.
- The Legislature amends the plans, creating additional costs or diverting the funds to other public purposes.

We should also note the above positive statements do not apply to the Judges Retirement System, which is not advance-funded.

Management and Organization

Our investigation uncovered weaknesses in the state's pension's management systems and organization. The systems used to control information flow, pension administration and design should be considered by the Legislature.

Specifically, we recommend the following issues be reviewed:

- Constituents don't feel they have adequate access to pension-related information. Comprehensive, yet understandable, reporting of pension-related matters is not provided to constituencies.
- Plan design is not an open process.

- Opposing views are not supported with actuarial expertise to the same extent as JCPP agendas. As such, the JCPP and the OSA promote a single perspective to the exclusion of others. In particular, the JCPP Executive Committee excludes ideas from consideration.

- Fiduciary responsibilities with respect to participants and beneficiaries may not be fixed and determinable.

- Whether state agencies and the Legislature should be authorized to obtain independent actuarial services. Current law states those services must be performed by OSA.

- There is no oversight of the State Actuary's management of OSA's operations.

- The extent of oversight needed.

- Setting operating and performance standards for the OSA.

- The relevancy of the provisions of Chapter 41.52, which creates the Public Pension Commission.

- Whether state pension system statutes need to be reviewed.

- Providing a more comprehensive orientation to policymakers on pension funding and cost-disclosure issues.

- The need for improved collaboration between JCPP, OSA and DRS.

- Policies on how fiscal effects of pension bills are developed and communicated.

We believe improvements in these areas will enhance the effectiveness of the state's pension system.

EXHIBIT A

ASSERTIONS INCLUDED IN THE INVESTIGATION

(1) Please see note of February 9, 1995. A poorly worded bill needed attention. We could price the bill as worded, or as intended, the two were different. His response was contingent upon who wrote the bill. It was someone he did not like so he said to go out with the higher cost and that would kill the bill.

(3) Please see note of February 15, 1995. A fiscal note was requested but one was never sent because it was for a legislator Jerry did not like.

(4) Please see notes of April 1, and April 9 1997. Our office has taken the position of "Working Bills". Is this the role of the Office of the State Actuary?

(5) Please see note of April 11, 1997. The determining factor as to whether or not a fiscal note has an example is whether or not the State Actuary likes the bill.

(6) Please see note of May 23, 1997. The "New Hire", Steve Nelsen, was surprised to hear that Senator Fraser's request for information (regarding contributions for the 97-99 biennium) from the last JCPP meeting would not be met.

(9) Please see note of 3-12-91. We went out with a fiscal note on a bill for the JRS to refund contributions for withdrawn (or non-re-elected) members. The Representative wanted the smallest possible cost to help get the bill through. After coming up with a cost of ($92,000) I asked Jerry four times if we could indicate this was an upper bound and that if members were no longer alive the cost would be lower. He said no. Jerry has always thought the Judges and JRS are very rich systems so the members should not get any benefit increases.

(11) Please see note of December 9, 1993. We were asked to practice "Actuarial Obfuscation". Jerry thought the visibility of a long term assumption of 5.25% salary increases would raise objections with employees whose raises were not as high as 5.25%. Thus, we should hide the salary increase assumption by mixing it in with an interest rate factor, annuity factors, etc.

(12) Please see note of December 9, 1993. Earlier today Jerry and I discussed the administration of recently passed FIB 1744. The bill allowed Officers at U.W. and the ports (who were members of PERS) to move to LEOFF II. In the past, as PERS employers, they had contributed both the PERS Plan II normal cost as well as a PERS I supplemental liability payment (about 5% and 2 1/2%). The old LEOFF II rate would have been about 7.6%. They will be required to make up

the difference. The bill language was not specific and it could be interpreted that the employer receive credit for either 5% or 7 1/2%, thus they would have to pay either .1% or 2.6% (I am simplifying here, but the point is made). Jerry said, "Makes you want to gouge them. If they come in asking for a pig in a poke they deserve anything they get. It's okay to overcharge them."

(14) Please see note of January 5, 1994. On more than one occasion we have drafted new language and found that a conflict arose when old language from another plan was used as a model. If we cleaned the language in the new plan then the conflict in language would highlight the problem in the old plan. Rather than open up a can of worms the problem is perpetuated. In this case we were discussing the employee's right to return to work in Plan III, and how it was administered for Plan II. Other examples would be membership for Union Representatives and the 3% COLA in PLAN II, and PLAN III**.**

(15) Please see note of June 1, 1995. The contribution rate increase for improving the PERS I out of service vested member is roughly .01% of pay. I had been asked to keep reviewing my assumptions until the cost came out to less than .0049% - and thus are rounded to 0.

(16) Please see note of August 29, 1995. Jerry decided that the new economic assumptions should be 8.0%, 5.5%, and 4% for investment, salary increases, and inflation respectively. After he decided what rates should be then he asked me to do research to support the decision. Some would do the research prior to the decision making.

(17) Please see note of February 16, 1997. Someone from OFM called inquiring about an early retirement package that included an incentive. In addition to an open window there would be additional benefits granted. The biennial cost, $75 million, was startling to Jerry. He said I should lower it to $25-50 million. Then he said I should not give the incentive to the older higher service members who were already eligible to retire. I mentioned the ADEA required that it go to everyone. The person at OFM, a highly skilled professional, insisted that the bill be priced with essentially everyone getting the incentive.

Do you feel the information on the POP-UP issue is objective?

(18) Please see draft of fiscal note for HB2017, dated 2/20/97. Please note the typed text was as I wrote it. The handwritten blue marks are mine, and the black is Jerry's. Please see the second page. Note that there was information on the Unfunded Liability and that Jerry removed it. Please not the difference between the original and final language.

(19) Please see handout on TRS III transfer payment from November 7, 1996 JCPP meeting. On page 2 towards the bottom the line titled "Combined Plan 2 & 3 rate" reads 5.8%, 5.9%, and 6.0%. For ten years this office has maintained a policy that every fiscal note go out with a rate expressed as a percentage with two decimal points. By rounding to 6.0% it appeared to be close to the 6.03% it

appears to be close to the line above. Not only should the value have two decimal places but if the number was rounded it should have been rounded to 5.9%, not 6.0%

(20) Members of the House Appropriations Committee have been misled to facilitate the passage of JCPP recommended bills. A recent example would be the change of the TRS 3 transfer payment from 20% to 40%. A legislator asked if there was going to be any debt passed on to future generations, if there was an increase in the Unfunded Liability. The truth is yes. The answer was no.

(24) Please see notes of June 13 & 14, 1995. Jerry would withhold information to punish DRS. In this case information for DRS for use in implementing the "Pop-Up" was available two weeks in advance and we were ordered not to send it.

(25) The transfer payment originally calculated for TRS 2 to TRS 3 was roughly 20%. The delays in getting TRS 3 enacted came in a period of great investments and other experience gains. The rate was later amended to 40%. When work was done for PERS recently there was constant pressure to find a way to make the PERS transfer payment 40% also. The numbers in PERS generated a much larger rate, so Jerry had me go back and change the length of the window involved, the amount on which the transfer was based, anything we could do and say it was a 40% transfer payment that would in reality be very close to an 80%. transfer if made on a basis comparable to TRS 3.

(26) JRS was closed July 1, 1988. In coming up with a method of funding the Unfunded Accrued Actuarial Liability my recommendations were all within actuarial principles and standards. Jerry directed me to come up with a method that would lower the required amount. We ended up with a method that amortized costs over the salaries of judges who are not members of JRS.

(28) See note of July 19, 1994. Representative Helen Sommers had asked us to consider an approach to excess compensation. Excess compensation has been an administrative nightmare for years. There was a history of legislation attempting to address the issue, but when self interest was involved people continued to find a way around the rules. Representative Sommers' idea was quite creative. Variations of this approach had been repeatedly brought up by Dr. Hollister and myself. Jerry did not want us to pursue the topic and respond to Representative Sommers.

(29) See letter of August 13, 1990. Amounts in plan I vs. II were all wrong. My assignment was to find out why. After finding out why nothing was done because there was no desire to rock the boat. (Eventually separate trust funds were created - but no improper transfers were ever reversed).

(33a) The statement made to Senator Jacobson about cash flows at the June JCPP was not correct.

(33b) Jerry was discussing the Volunteer Firefighters' Relief & Pension Fund and on occasions mentioned their cash flow. To an actuary this is blasphemy, not one four letter word but two! A pension fund (unless it is teetering on bankruptcy) measures liabilities on a present value basis, not cash flow.

(37) *Please see attached handout on TRS I benefits with and without withdrawn contributions.* The factors used *in* this calculation do not comply with statute. I calculated the required factors twice, once according to statute, once according to Jerry's specifications. I refused to sign a letter to DRS that would be accompanied by the wrong factors. The cost of correcting the benefits, and making up past under-payments is somewhere around $150 million. If this was corrected for currently employed members there would be an *additional cost* of about $200 million if the interest rate continues at 7.5%. If economic assumptions are changed and the investment assumption does go to 8.0%, the amount would increase even more.

(38) I had called Bob Bramlet at GASB to determine whether Plans I and Plans II should be treated as one plan or two. (The combining of the poorly funded plans I with the well funded plans II, would create the impression of a moderately funded system and mask the under-funding). I mentioned that Mr. Bramlet said we had to split them. Jerry said, “fortunately he isn't going to be the one making the decision” _ Bob Bramlet wrote GASB 5.

(42) Please see notes of February 15 & 19, 1997. During the 1997 legislative session a bill came up that would allow Plan I members to cease making contributions in exchange for “freezing" their AFC at the amount attained at 30 years. Jerry objected to the fiscal note on the grounds that the long term assumption for salaries of 5% was higher than recent increases. Using a 2% or 3% increase would develop more costs. I pointed out that Statute required us to price bills with the long term assumptions. Not only was he ignoring the methods in statute, but Jerry wrote that section of statute.

(46) The 1970's and 1980's were a period of chronic under-funding of the state's pension plans. A common approach was to have the office produce the rates required by statute and then someone would ask for the amount required by the "earned benefit" approach (the Unit Credit method). The earned benefit developed a very bad name and was something legislators were trying to get away from when they adopted a new method. Jerry's new Funding Method would produce a 1989-91 LEOFF contribution of less than the "earned benefit" cost (albeit $1,000,000). Jerry then changed the figures for LEOFF to make the new funding method equal "Earned Benefits" (Accrued Benefit, Unit Credit).

(47) The table below indicates the Unfunded Accrued Actuarial Liability (UAAL) in 1986 and again ten years later. Please keep in mind that the *increase* in UAAL (debt) of over a billion dollars has taken place during the greatest bull market

any of us will live through and that assumptions are much more permissive now.

UAAL in Millions	1986	Current
PERS I	$2,238	$3,388
TRS I	$2,253	$2,563
LEOFF I	$ 992	$ 677
TOTAL	**$5,483**	**$6,628**

(50) One of the consequences of the funding chapter will appear in the 1997 CAFR. New accounting standards prohibit the use of our funding method in annual statements. When we display the amounts actually contributed, and the amounts required, we will not be allowed to use the results of the most current valuation. Instead we will use any one of four commonly accepted methods. The under-funding will be disclosed as an addition to the long term debt account. Earlier this year, before the 1996 valuations were completed, the State's share of the under-funding of PERS was about $80 million dollars. There is an open question as to whether or not the state's CAFR should disclose under-funding for TRS or LEOFF. Some believe the members of these Systems are not State employees and therefore there should be no disclosure. Others believe the state is funding these employees and responsible statutorily for their pensions, so the under-funding of their systems should be disclosed. If TRS & LEOFF under-funding were disclosed the amounts would be $147 million and $57 million respectively (using 1995 figures).

(52) The selling of the plan - - It was said to be cost neutral. However this was only close to true in the most narrow of cases. First, the mix of PERS & TRS costs varied from the old COLA. Thus, the General Fund cost was about the same, but Local Government costs would rise. Second, and more important, costs started out the same, but declined rapidly for the old COLA, and increased sharply under the new. In sum, a bill described as cost-neutral created an increase in unfunded liabilities of hundreds of millions of dollars. *Please refer to the file and attached picture.*

(53) There was another significant problem with the legislation. Some members would be better off under the new COLA, others would lose out under the new Cola. The universal standard of actuarial practice to compare benefits is the present value calculation. Using this accepted approach the more highly paid as well as virtually all active employees would be better off under the old Cola. Rather than use present values to compare the value of the two COLAs a comparison of the payments made by each COLA within 10 years of effective date of the act. Though convenient, this approach is without merit. if this were to be challenged in court I would have to say it is an invalid way to determine whether or not we were harming the member by changing the COLA. Please see the attached

(57) After investments have a great run up two things generally happen, first, those who have a vested interest begin to get excited and their expectations grow, and those with more detachment recognize mean reversion. Mean reversion is a tendency to revert to the trend-line. Though this principle is thoroughly understood and even espoused by the State Actuary he has spent much of the last 6 months planning to have the investment return rate increased to 8.0%.

(66a) Please see note of April 11, 1997. Jerry mentions the investment return assumption should be raised to 8.0%.

(66b) Please see note of May 29, 1997. Jerry discussed the changing of economic assumptions. He did not say, "Investment return is assumed to be 7.5%, what might happen if it goes up or down a half a percentage point?" However, he did say to run some valuations at 8.0%. He had mentioned this many times previously.

(66c) Please see note of June 11, 1997. Jerry says the investment return rate should go up to 8.0%. No research has been done. No studies have been made.

(66d) Please see note of June 19, 1997. At the Joint Committee on Pension Policy meeting today Tim Parker said they had a short term (was it five years?) prediction that markets would average 5% annually. Jerry again says the invest assumption should be raised to 8.0%.

(66e) Please see note of June 22, 1997. Jerry is anticipating the 1998 Legislature. They will see valuation results indicating lower rates and will want a "pension grab" as they did in 1993. He would prepare by having us cost various proposals for all the interest groups so that we could pass around the savings. The savings would be increased by changing the investment rate to 8% which lowers contributions.

(66f) June 30, 1997. Jerry told me interest rates were going to go up to 8% (assumption of investment return) and this would lower contribution rates. We have to be ready for this by preparing costs for lowering the retirement age of Plan II.

(66g) July 2, 1997. In reference to the Economic & Revenue Forecast Council Jerry said with resignation, "We may not be able to be the drivers. We may not be the determiners. We may just do the inputs."

(66h) July 3, 1997. Jerry asked me to run valuations at 8.0% interest rate assumption. He said the Legislature is going to want to take the $100 million for the difference between the contributions required by the 1995 valuations and the 1996 valuations. Additionally rates were going to go up to 8.0% so there might be another $100 million drop.

(70) When John Charles was hired as director of DRS there was a mistaken impression that he was black. Jerry made several remarks, referencing him as singer Ray Charles' cousin, etc. Sandi specifically referenced laws about human rights and said that kind of talk was not allowed. Jerry said "Those don't matter."

(71) Please see notes of May 23, the note of May 29, and the attached subpoena. The AGO's office was defending DRS and one of their attorney's asked me to appear. Normally my testimony is in written form and the lawyers argue legal points rather than my calculations. However, in this particular case the plaintiff's lawyers insisted on cross examination. When the date was set and Jerry notified, he insisted that the Judge change the hearing date or that I not go. Upon hearing this the AGO's office issued a subpoena for me to attend the hearing. Jerry told me he was going to call the AG as they had no authority to issue an subpoena.

(72a) At the May meeting of the executive committee the office budget was discussed and the awarding of a contract for review of the fiscal notes was mentioned. Representative Sommers was aghast that a contract be awarded for the form or appearance of the fiscal notes. She believed they had to be auditing the numbers. Jerry said the were doing more, they were auditing. Sandi Granger, who reviews the contracts as part of her duties as office manager knew the contract specifically excluded any review of the numbers. She blurted out "AUDIT?" And suddenly realized she was on thin ice.

(72b) Jerry had asked me to write the Request for Services proposal. Checking the numbers was excluded from the beginning. It was technically not an audit but a review so Jerry could exercise more control over the project. The intent from the beginning was to obtain a letter that could be waived in front of the Joint Committee on Pension Policy to indicate the Office was okay. The concern about content was secondary at best. When the consultant produced a detailed letter he complained on three separate occasions. Each time he made a comment along the lines of "We just need something that says we're doing okay."

(73) Jerry arranged an appointment in Wyatt's Chicago office to discuss Asset Liability Matching despite Wyatt's having an office in Seattle. He said he was going to have the state pay for his visit to his sister.

(74) Jerry was discussing the budget with Sandi and I, in particular travel to professional meetings. Jerry said he had looked at a map and realized he had never gone to Alaska so he should find a meeting there. That summer he went to a conference for teachers retirement systems in Alaska.

(75) Upon completion of our 1989-94 experience study a contract was awarded for an audit of our work. Norm Losk, who was Jerry's first boss here, had just

started his own business and Jerry wanted him to get the business. Jerry assembled a task force to oversee the selection process. He then picked several people he knew would be rejected for various reasons. Ed Friend did a lot of work in the Public sector and Jerry said Sheryl Wilson (former director of DRS) particularly disliked him. Others were solicited because they were very expensive. Jerry told Norm Losk what the other bids were coming in at and he under bid them. This allowed Norm to get the business

(85) A recent example might be from the most recent executive committee of the JCPP. The issue of a Cost of Living Adjustment (COLA) for members of the Judges Retirement System was raised. The Judges system has other problems that could be dovetailed into one bill and we could take care of several things in one effort. It was recommended that one option taken to the JCPP be the transferring of judges from their system into PERS I where members automatically get the "Uniform COLA". Some advantages of this would be 1) they get a COLA, 2) it is hard to argue for a larger COLA when this is what is given to the largest group of retirees in the state, 3) an underfunded system would have a more stable funding method, 4) DRS and OFM would have one less fund to deal with and there would be associated administrative cost savings. We were not to put that on the table.